

## Income Assessment

### Introduction

This chapter describes the requirements for evaluating income stability, adequacy, and likelihood of continuance — key factors used in qualifying the borrower and assessing his or her capacity to repay the mortgage over the life of the loan.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-01, General Income Information (12/16/2020)

#### REVISION HISTORY 08/07/2019

REVISION NUMBER: 08072019      DATE: 08/07/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-3.1-01, General Income Information (08/07/2019)

#### Introduction

This topic contains information on employment income, including:

- Stable and Predictable Income
- Variable Income
- Continuity of Income
- Determining the Need for Federal Income Tax Returns
- Verification of Income for Non-U.S. Citizen Borrowers
- Using Nontaxable Income to Adjust the Borrower's Gross Income
- Reduced Income Documentation Requirements for High LTV Refinance Loans

#### Stable and Predictable Income

Fannie Mae's underwriting guidelines emphasize the continuity of a borrower's stable income. The stable and reliable flow of income is a key consideration in mortgage loan underwriting. Individuals who change jobs frequently, but who are nevertheless able to earn consistent and predictable income, are also considered to have a reliable flow of income for qualifying purposes.

To demonstrate the likelihood that a consistent level of income will continue to be received for borrowers with less predictable sources of income, the lender must obtain information about prior earnings. Examples of less predictable income sources include commissions, bonuses, substantial amounts of overtime pay, or employment that is subject to time limits, such as contract employees or tradesmen.

#### Variable Income

All income that is calculated by an averaging method must be reviewed to assess the borrower's history of receipt, the frequency of payment, and the trending of the amount of income being received. Examples of income of this type include income from hourly workers with fluctuating hours, or income that includes commissions, bonuses, or overtime.

**History of Receipt:** Two or more years of receipt of a particular type of variable income is recommended; however, variable income that has been received for 12 to 24 months may be considered as acceptable income, as long as the borrower's loan application demonstrates that there are positive factors that reasonably offset the shorter income history.

**Frequency of Payment:** The lender must determine the frequency of the payment (weekly, biweekly, monthly, quarterly, or annually) to arrive at an accurate calculation of the monthly income to be used in the trending analysis (see below). Examples:

- If a borrower is paid an annual bonus on March 31<sup>st</sup> of each year, the amount of the March bonus should be divided by 12 to obtain an accurate calculation of the current monthly bonus amount. Note that dividing the bonus received on March 31<sup>st</sup> by three months produces a much higher, inaccurate monthly average.
- If a borrower is paid overtime on a biweekly basis, the most recent paystub must be analyzed to determine that both the current overtime earnings for the period and the year-to-date overtime earnings are consistent and, if not, why. There are legitimate reasons why these amounts may be inconsistent yet still eligible for use as qualifying income. For example, borrowers may have overtime income that is cyclical (transportation employees who operate snow plows in winter, package delivery service workers who work longer hours through the holidays). The lender must investigate the difference between current period overtime and year-to-date earnings and document the analysis before using the income amount in the trending analysis.

**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 signed federal income tax returns (or a standard Verification of Employment completed by the employer or third-party employment verification vendor).

- 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.

#### Continuity of Income

A key driver of successful homeownership is confidence that all income used in qualifying the borrower will continue to be received by the borrower for the foreseeable future. Unless the lender has knowledge to the contrary, if the income does not have a defined expiration date and the applicable history of receipt of the income is documented (per the specific income type), the lender may conclude that the income is stable, predictable, and likely to continue. The lender is not expected to request additional documentation from the borrower.

If the income source does have a defined expiration date or is dependent on the depletion of an asset account or other limited benefit, the lender must document the likelihood of continued receipt of the income for at least three years.

If the lender is notified that the borrower is transitioning to a lower pay structure, for example due to pending retirement, the lender must use the lower amount to qualify the borrower.

The following table contains examples of income types with and without defined expiration dates. This information is provided to assist lenders in determining whether additional income documentation may be necessary to support a three-year continuance. Note that lenders remain responsible for making the final determination of whether the borrower's specific income source has a defined expiration date.

Expiration Date Not Defined	Defined Expiration Date*
<p>Lender does not need to document 3-year continuance</p> <ul style="list-style-type: none"> <li>• automobile allowance</li> <li>• base salary</li> <li>• bonus, overtime, commission, or tip income</li> <li>• capital gains income</li> <li>• corporate retirement or pension</li> <li>• disability income — long-term</li> <li>• foster-care income</li> <li>• interest and dividend income (unless other evidence that asset will be depleted)</li> <li>• military income</li> <li>• mortgage credit certificates</li> <li>• part-time job, second job, or seasonal income</li> <li>• rental income</li> <li>• self-employment income</li> <li>• Social Security, VA, or other government retirement or annuity</li> </ul>	<p>Lender must document 3-year continuance</p> <ul style="list-style-type: none"> <li>• alimony or child support</li> <li>• distributions from a retirement account – for example, 401(k), IRA, SEP, Keogh</li> <li>• mortgage differential payments</li> <li>• notes receivable</li> <li>• public assistance</li> <li>• royalty payment income</li> <li>• Social Security (not including retirement or long-term disability)</li> <li>• trust income</li> <li>• VA benefits (not including retirement or long-term disability)</li> </ul>

\*Because these income sources have a defined expiration date or allow the depletion of an asset, care must be taken when this is the sole source or majority of qualifying income. Lenders must consider the borrower's continued capacity to repay the mortgage loan when the income source expires or the distributions will deplete the asset prior to maturation of the mortgage loan.

Income sources that are not listed above will require lender judgment to determine if documentation of continuance must be obtained.

### Determining the Need for Federal Income Tax Returns

The lender must obtain copies of the borrower's signed federal income tax returns filed with the IRS for the past one or two years (depending on the income type) for the following sources of income or employment. Refer to the applicable topics in Chapter B3-3, Income Assessment for additional information about specific tax return requirements.

Tax returns are required if the borrower

- is employed by family members (two years' returns);
- is employed by interested parties to the property sale or purchase (two years' returns);
- receives rental income from an investment property;
- receives income from temporary or periodic employment (or unemployment) or employment that is subject to time limits, such as a contract employee or a tradesman;
- receives income from capital gains, royalties, or other miscellaneous non-employment earnings reported on IRS Form 1099;
- receives income that cannot otherwise be verified by an independent and knowledgeable source (two years' returns);
- uses foreign income to qualify;
- uses interest and dividend income to qualify;
- uses tip income reported on IRS Form 4137 that was not reported by the employer on the W-2 to qualify; or
- receives income from sole proprietorships, limited liability companies, partnerships, or corporations, or any other type of business structure in which the borrower has a 25% or greater ownership interest. Borrowers with a 25% or greater ownership interest are considered self-employed. The lender must document and underwrite the loan application using the requirements for self-employed borrowers, as described in Section B3-3.2, Self-Employment Income. Note that for DU loan casefiles, only the most recent year of tax returns may be required.

If a borrower's income is validated by the DU validation service, lenders are not required to determine if the borrower is employed by a family member or interested party to the property sale or purchase. See B3-2-02, DU Validation Service (10/07/2020).

See B3-3.1-06, Requirements and Uses of IRS Request for Transcript of Tax Return Form 4506-T (07/03/2019), for information about obtaining tax return transcripts.

### Verification of Income for Non-U.S. Citizen Borrowers

The following table describes income verification requirements for borrowers who are non-U.S. citizens:

Employment Type	Employment and Income Verification Requirements
Salaried or commissioned borrower employed by a U.S. company or individual	Same as for a U.S. citizen. See Section B3-3.1, Employment and Other Sources of Income.
Self-employed	Same as for a U.S. citizen. See Section B3-3.2, Self-Employment Income.
Employed by a foreign corporation or a foreign government and paid in foreign currency ("foreign income")	<p>The lender must obtain:</p> <ul style="list-style-type: none"> <li>• copies of the borrower's signed federal income tax returns filed with the IRS for the most recent two-year period, and</li> <li>• documentation to satisfy the standard documentation requirements in this Chapter.</li> </ul> <p><b>Note:</b> All income must be translated to U.S. dollars.</p>

For information on U.S. citizens earning foreign income, refer to B3-3.1-09, Other Sources of Income (10/02/2019).

### Using Nontaxable Income to Adjust the Borrower's Gross Income

The lender should give special consideration to regular sources of income that may be nontaxable, such as child support payments, Social Security benefits, workers' compensation benefits, certain types of public assistance payments, and food stamps.

The lender must verify that the particular source of income is nontaxable. Documentation that can be used for this verification includes award letters, policy agreements, account statements, or any other documents that address the nontaxable status of the income.

If the income is verified to be nontaxable, and the income and its tax-exempt status are likely to continue, the lender may develop an "adjusted gross income" for the borrower by adding an amount equivalent to 25% of the nontaxable income to the borrower's income.

If the actual amount of federal and state taxes that would generally be paid by a wage earner in a similar tax bracket is more than 25% of the borrower's nontaxable income, the lender may use that amount to develop the adjusted gross income, which should be used in calculating the borrower's qualifying ratio.

### Reduced Income Documentation Requirements for High LTV Refinance Loans

For certain high LTV refinance loans, lenders are not required to follow the income documentation requirements described in this Chapter. Refer to Chapter B5-7: High Loan-to-Value Refinance Option for specific requirements.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2013-06	August 20, 2013
Announcement SEL-2012-06	June 26, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-02	March 2, 2010

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Tax returns are required if the borrower

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- receives income from capital gains, royalties, or other miscellaneous non-employment earnings reported on IRS Form 1099;
- receives income that cannot otherwise be verified by an independent and knowledgeable source (two years' returns);
- uses foreign income to qualify;
- uses interest and dividend income to qualify;

- uses tip income reported on IRS Form 4137 that was not reported by the employer on the W-2 to qualify; or
- receives income from sole proprietorships, limited liability companies, partnerships, or corporations, or any other type of business structure in which the borrower has a 25% or greater ownership interest. Borrowers with a 25% or greater ownership interest are considered self-employed. The lender must document and underwrite the loan application using the requirements for self-employed borrowers, as described in Section B3-3.2, Self-Employment Income. Note that for DU loan casefiles, only the most recent year of tax returns may be required.

If a borrower's income is validated by the DU validation service, lenders are not required to determine if the borrower is employed by a family member or interested party to the property sale or purchase. See B3-2-02, DU Validation Service (10/07/2020).

See B3-3.1-06, Requirements and Uses of IRS IVES Request for Transcript of Tax Return Form 4506-C (12/16/2020), for information about obtaining tax return transcripts.

### Verification of Income for Non-U.S. Citizen Borrowers

The following table describes income verification requirements for borrowers who are non-U.S. citizens:

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Employed by a foreign corporation or a foreign government and paid in foreign currency ("foreign income")	<p>The lender must obtain:</p> <ul style="list-style-type: none"> <li>• copies of the borrower's signed federal income tax returns filed with the IRS for the most recent two-year period, and</li> <li>• documentation to satisfy the standard documentation requirements in this Chapter.</li> </ul> <p><b>Note:</b> All income must be translated to U.S. dollars. ®</p>

For information on U.S. citizens earning foreign income, refer to B3-3.1-09, Other Sources of Income (12/16/2020).

### Using Nontaxable Income to Adjust the Borrower's Gross Income

The lender should give special consideration to regular sources of income that may be nontaxable, such as child support payments, Social Security benefits, workers' compensation benefits, certain types of public assistance payments, and food stamps.

The lender must verify that the particular source of income is nontaxable. Documentation that can be used for this verification includes award letters, policy agreements, account statements, or any other documents that address the nontaxable status of the income.

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If the actual amount of federal and state taxes that would generally be paid by a wage earner in a similar tax bracket is more than 25% of the borrower's nontaxable income, the lender may use that amount to develop the adjusted gross income, which should be used in calculating the borrower's qualifying ratio.

### Reduced Income Documentation Requirements for High LTV Refinance Loans

For certain high LTV refinance loans, lenders are not required to follow the income documentation requirements described in this Chapter. Refer to Chapter B5-7: High Loan-to-Value Refinance Option for specific requirements.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2013-06	August 20, 2013
Announcement SEL-2012-06	June 26, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-02	March 2, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-02, Standards for Employment Documentation (12/16/2020)

**B3-3.1-02, Standards for Employment Documentation (10/24/2016)**

**Introduction**

This topic contains information on the standards for documentation of employment income, including:

- General Documentation Requirements
- Employment Documentation Provided by the Borrower
- Employment Documentation Provided by the Borrower’s Employer
- Employment Documentation Provided by a Third-Party Employment Verification Vendor

**General Documentation Requirements**

The lender must verify employment income for all borrowers whose income is used to qualify for the mortgage loan. This verification can be provided by the borrower, by the borrower’s employer, or by a third-party employment verification vendor.

**Employment Documentation Provided by the Borrower**

The following table provides requirements for documentation provided by the borrower.

✓	<b>Requirements – Paystubs and W-2s</b>
	The paystub must be dated no earlier than 30 days prior to the initial loan application date and it must include all year-to-date earnings. Additionally, the paystub must include sufficient information to appropriately calculate income; otherwise, additional documentation must be obtained. Paystubs must comply with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018).
	IRS W-2 forms must cover the most recent one- or two-year period, based on the documentation requirements for the particular income type. The W-2 forms must clearly identify the borrower as the employee. “Most recent” W-2 is defined as the W-2 for the calendar year prior to the current calendar year. Alternative documentation, such as an IRS Wage and Income (W-2) Transcript, a written <i>Request for Verification of Employment</i> (Form 1005 or Form 1005(S)) (see below) or the final year-to-date paystub, may be used as long as adequate information is provided.
	Documents must 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.
	The documents must clearly identify the borrower as the employee.
	The information must be complete and legible.
	The original source of the information must be a third party, such as the borrower’s human resources department, personnel office, payroll department, company’s payroll vendor, or supervisor.
✓	<b>Requirements – Tax Returns</b>
	When required, personal federal income tax returns must be copies of the original returns that were filed with the IRS. All supporting schedules must be included. Alternatively, the lender may obtain applicable transcripts of federal income tax returns. See B3-3.1-06, Requirements and Uses of IRS Request for Transcript of Tax Return Form 4506-T (07/03/2019). “Most recent” tax return is defined as the last return scheduled to have been filed with the IRS. See B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018).
	The information must be complete and legible.
	Each tax return must be signed by the borrower unless the lender has obtained one of the following signature alternatives: <ul style="list-style-type: none"> <li>• documentation confirming that the tax returns were filed electronically,</li> <li>• a completed IRS Form 4506-T (signed by the borrower) for the year in question, or</li> <li>• IRS transcripts that validate the tax return.</li> </ul>

**Employment Documentation Provided by the Borrower’s Employer**

The lender may use the *Request for Verification of Employment* (Form 1005 or Form 1005(S)) to document income for a salaried or commissioned borrower. The date of the completed form must comply with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018).

The information on the Form 1005 or Form 1005(S) must be legible. The following fields on the form are optional:

Field #	Title of Optional Field
11	Probability of continued employment
14	If overtime or bonus is applicable, is its continuance likely?
16	Date of applicant’s next pay increase
17	Projected amount of next pay increase
18	Date of applicant’s last pay increase
19	Amount of last pay increase

The remaining fields on the form must be completed as applicable to the borrower. For example, overtime may not be completed if the borrower is in a position that does not pay overtime.

When the borrower authorizes the lender to obtain verifications of employment and income directly from the employer, the lender must have the borrower sign Form 1005 or Form 1005(S).

Alternatively, the lender may have the applicant sign a signature authorization form, which gives the lender blanket authorization to request the information it needs to evaluate the applicant's creditworthiness (see B1-1-02, Blanket Authorization Form (04/01/2009)).

### Employment Documentation Provided by a Third-Party Employment Verification Vendor

The lender may receive employment and income verification directly from a third-party employment verification vendor. These verifications are acceptable as long as

- the borrower provided proper authorization for the lender to use this verification method,
- the date of the completed verification is in compliance with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018),
- the lender has determined that the vendor has made provisions to comply with reasonable quality control requests from both the lender and any subsequent mortgagee, and
- the lender understands it will be held accountable for the integrity of the information obtained from this source.

If necessary, the lender must supplement these verifications by obtaining any missing information from the borrower or his or her employer.

Loans that are submitted through the DU validation service must comply with all requirements pertaining to the DU validation service. See B3-2-02, DU Validation Service (10/07/2020).

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement -2009-19	June 8, 2009

### B3-3.1-02, Standards for Employment Documentation (12/16/2020)

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#### General Documentation Requirements

The lender must verify employment income for all borrowers whose income is used to qualify for the mortgage loan. This verification can be provided by the borrower, by the borrower's employer, or by a third-party employment verification vendor.

#### Employment Documentation Provided by the Borrower

The following table provides requirements for documentation provided by the borrower.

✓	Requirements — Paystubs and W-2s
	The paystub must be dated no earlier than 30 days prior to the initial loan application date and it must include all year-to-date earnings. Additionally, the paystub must include sufficient information to appropriately calculate income; otherwise, additional documentation must be obtained. Paystubs must comply with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020).
	IRS W-2 forms must cover the most recent one- or two-year period, based on the documentation requirements for the particular income type. The W-2 forms must clearly identify the borrower as the employee. "Most recent" W-2 is defined as the W-2 for the calendar year prior to the current calendar year. Alternative documentation, such as an IRS Wage and Income (W-2) Transcript, a written <i>Request for Verification of Employment</i> (Form 1005 or Form 1005(S)) (see below) or the final year-to-date paystub, may be used as long as adequate information is provided.
	Documents must 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.

	The documents must clearly identify the borrower as the employee.
	The information must be complete and legible.
	The original source of the information must be a third party, such as the borrower's human resources department, personnel office, payroll department, company's payroll vendor, or supervisor.
✓	<b>Requirements — Tax Returns</b>
	When required, personal federal income tax returns must be copies of the original returns that were filed with the IRS. All supporting schedules must be included. Alternatively, the lender may obtain applicable transcripts of federal income tax returns. See B3-3.1-06, Requirements and Uses of IRS IVES Request for Transcript of Tax Return Form 4506-C (12/16/2020). "Most recent" tax return is defined as the last return scheduled to have been filed with the IRS. See B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020).
	The information must be complete and legible.
	Each tax return must be signed by the borrower unless the lender has obtained one of the following signature alternatives: <ul style="list-style-type: none"> <li>• documentation confirming that the tax returns were filed electronically,</li> <li>• a completed IRS Form 4506-C (signed by the borrower) for the year in question, or</li> <li>• IRS transcripts that validate the tax return.</li> </ul>

### Employment Documentation Provided by the Borrower's Employer

The lender may use the *Request for Verification of Employment* (Form 1005 or Form 1005(S)) to document income for a salaried or commissioned borrower. The date of the completed form must comply with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020).

The information on the Form 1005 or Form 1005(S) must be legible. The following fields on the form are optional:

Field #	Title of Optional Field
11	Probability of continued employment
14	If overtime or bonus is applicable, is its continuance likely?
16	Date of applicant's next pay increase
17	Projected amount of next pay increase
18	Date of applicant's last pay increase
19	Amount of last pay increase
24	Reason for leaving (Part III — Verification of Previous Employment)

The remaining fields on the form must be completed as applicable to the borrower. For example, overtime may not be completed if the borrower is in a position that does not pay overtime.

When the borrower authorizes the lender to obtain verifications of employment and income directly from the employer, the lender must have the borrower sign Form 1005 or Form 1005(S).

Alternatively, the lender may have the applicant sign a signature authorization form, which gives the lender blanket authorization to request the information it needs to evaluate the applicant's creditworthiness (see B1-1-02, Blanket Authorization Form (04/01/2009)).

### Employment Documentation Provided by a Third-Party Employment Verification Vendor

The lender may receive employment and income verification directly from a third-party employment verification vendor. These verifications are acceptable as long as

- the borrower provided proper authorization for the lender to use this verification method,
- the date of the completed verification is in compliance with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020),
- the lender has determined that the vendor has made provisions to comply with reasonable quality control requests from both the lender and any subsequent mortgagee, and
- the lender understands it will be held accountable for the integrity of the information obtained from this source.

If necessary, the lender must supplement these verifications by obtaining any missing information from the borrower or his or her employer.

Loans that are submitted through the DU validation service must comply with all requirements pertaining to the DU validation service. See B3-2-02, DU Validation Service (10/07/2020).

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2013-04	May 28, 2013

Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-03, Base Pay (Salary or Hourly), Bonus, and Overtime Income (05/15/2012)

### B3-3.1-03, Base Pay (Salary or Hourly), Bonus, and Overtime Income (05/15/2012)

#### Introduction

This topic contains information on base pay (salary and hourly), bonus, and overtime income, including:

- Verification of Base Pay, Bonus, and Overtime Income
- Base Income Calculation Guidelines
- Military Income

#### Verification of Base Pay, Bonus, and Overtime Income

The following table provides verification requirements for base pay, bonus, and overtime income:

✓	Verification of Base Pay, Bonus, and Overtime Income
	A minimum history of two years of employment income is recommended. However, income that has been received for a shorter period of time may be considered as acceptable income, as long as the borrower's employment profile demonstrates that there are positive factors to reasonably offset the shorter income history. Borrowers relying on overtime or bonus income for qualifying purposes must have a history of no less than 12 months to be considered stable.
	<b>Base Pay (Salary and Hourly):</b> Obtain the following documents: <ul style="list-style-type: none"> <li>• a completed <i>Request for Verification of Employment</i> (Form 1005 or Form 1005(S)), or</li> <li>• the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.</li> </ul>
	<b>Bonus or Overtime:</b> Obtain the following documents: <ul style="list-style-type: none"> <li>• a completed Form 1005 or Form 1005(S), or</li> <li>• the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.</li> </ul>
	See B3-3.1-01, <i>General Income Information</i> (12/16/2020), for additional information on calculating variable income (applies to hourly paid employees with fluctuating hours and bonus and overtime).
	If the borrower has recently changed positions with his or her employer, determine the effect of the change on the borrower's eligibility and opportunity to receive bonus or overtime pay in the future.
	If a borrower who has historically been employed on a part-time basis indicates that he or she will now be working full-time, obtain written confirmation from the borrower's employer.
	A verbal VOE is required from each employer. See B3-3.1-07, <i>Verbal Verification of Employment</i> (10/02/2018), for specific requirements.
	See B3-3.1-02, <i>Standards for Employment Documentation</i> (12/16/2020), for additional information about verifying employment income.

#### Base Income Calculation Guidelines

After the applicable income documentation has been obtained, the lender must calculate the borrower's eligible qualifying base income. The following table provides guidance for standard employment documentation:

How Often Paid	How to Determine Monthly Income
Annually	Annual gross pay / 12 months
Monthly	Use monthly gross payment amount
Twice Monthly	Twice monthly gross pay x 2 pay periods
Biweekly	(Biweekly gross pay x 26 pay periods) / 12 months
Weekly	(Weekly gross pay x 52 pay periods) / 12 months
Hourly	(Hourly gross pay x average # of hours worked per week x 52 weeks) / 12 months

All of the above calculations must be compared with the documented year-to-date base earnings (and past year earnings, if applicable) to determine if the income amount appears to be consistent. See B3-3.1-01, *General Income Information* (12/16/2020), for additional information about variable income (bonus and overtime).

## Military Income

Military personnel may be entitled to different types of pay in addition to their base pay. Flight or hazard pay, rations, clothing allowance, quarters' allowance, and proficiency pay are acceptable sources of stable income, as long as the lender can establish that the particular source of income will continue to be received in the future.

Income paid to military reservists while they are satisfying their reserve obligations also is acceptable if it satisfies the same stability and continuity tests applied to secondary employment.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-13	September 20, 2010
Announcement -2009-37	December 30, 2009
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-04, Commission Income (12/04/2018)

### B3-3.1-04, Commission Income (12/04/2018)

#### Introduction

This topic contains information on the verification of commission income.

#### Verification of Commission Income

The following table provides verification requirements for commission income.

✓	Verification of Commission Income
	A minimum history of 2 years of commission income is recommended; however, commission income that has been received for 12 to 24 months may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history.
	One of the following must be obtained to document commission income: <ul style="list-style-type: none"><li>• a completed <i>Request for Verification of Employment</i> (Form 1005 or Form 1005(S)), or</li><li>• the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.</li></ul>
	A verbal VOE is required from each employer. See B3-3.1-07, Verbal Verification of Employment (10/02/2018), for specific requirements.
	See B3-3.1-01, General Income Information (12/16/2020), for additional information about calculating variable income.
	See B3-3.1-02, Standards for Employment Documentation (12/16/2020), for additional information about verifying employment income.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-13	September 20, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-05, Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (08/07/2019)

### B3-3.1-05, Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (08/07/2019)

#### Introduction

This topic contains information on income from secondary and seasonal employment, including:

- Documentation Requirements
- Verification of Secondary Employment Income
- Verification of Seasonal Income

#### Documentation Requirements

The income sources discussed in this topic must be documented by obtaining the following:

- a completed *Request for Verification of Employment* (Form 1005 or Form 1005(S)); or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period. (Signed federal income tax returns may also be required to verify unemployment income related to seasonal employment.)

A verbal VOE is also required from each employer. See B3-3.1-07, *Verbal Verification of Employment* (10/02/2018), for specific requirements.

As these income types may be hourly or seasonal, refer to B3-3.1-01, *General Income Information* (12/16/2020), for additional information on calculating variable income. Also see B3-3.1-02, *Standards for Employment Documentation* (12/16/2020), for additional information about verifying employment income.

### Verification of Secondary Employment Income

Secondary employment income is income that is derived from a second job or multiple jobs the borrower may have. The lender must verify the following.

✓	Verification of Secondary Employment Income
	Verification of a minimum history of two years of uninterrupted secondary employment income is recommended. However, income that has been received for a shorter period of time (no less than 12 months) may be considered as acceptable income, as long as there are positive factors to reasonably offset the shorter income history.
	A borrower may have a history that includes different employers, which is acceptable as long as income has been consistently received.

### Verification of Seasonal Income

The lender must verify the following for seasonal income.

✓	Verification of Seasonal Income
	Verify that the borrower has worked in the same job (or the same line of seasonal work) for the past two years.
	Confirm with the borrower's employer that there is a reasonable expectation that the borrower will be rehired for the next season.
	For seasonal unemployment compensation, verify that it is appropriately documented, clearly associated with seasonal layoffs, expected to recur, and reported on the borrower's signed federal income tax returns. Otherwise, unemployment compensation cannot be used to qualify the borrower. See B3-3.1-09, <i>Other Sources of Income</i> (12/16/2020), for more information on unemployment benefits.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2014-06	May 27, 2014
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-13	September 30, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-06, Requirements and Uses of IRS IVES Request for Transcript of Tax Return Form 4506-C (12/16/2020)

**REVISION HISTORY** 07/03/2019

**REVISION NUMBER:** 07032019      **DATE:** 07/03/2019

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-3.1-06, Requirements and Uses of IRS Request for Transcript of Tax Return Form 4506-T (07/03/2019)

### Introduction

This topic contains information on the use of *IRS Request for Transcript of Tax Return* (IRS Form 4506-T), including:

- Use of IRS Form 4506-T to Validate Borrower Income Documentation
- Use of IRS Forms to Obtain Federal Income Tax Information
- Alternatives to the IRS Form 4506-T
- Completing and Submitting the IRS Authorization Form
- Retaining the Tax Documents

### Use of IRS Form 4506-T to Validate Borrower Income Documentation

Fannie Mae requires lenders to have each borrower whose income (regardless of income source) is used to qualify for the loan to complete and sign a separate IRS Form 4506-T at or before closing. (As noted below in *Completing and Submitting the IRS Authorization Form*, it may be necessary to have the borrower complete and sign multiple IRS Form 4506-Ts depending on the transcripts required to validate the income.)

In addition, the lender must document the requirement to obtain tax transcripts by submitting the IRS Form 4506-T to the IRS (directly or

through an authorized designee) in their written quality control (QC) plan. See D1-3-02, Lender Post-Closing Quality Control Review of Approval Conditions, Underwriting Decisions, and Documentation (08/07/2019) for details concerning QC requirements.

If the lender submits the IRS Form 4506-T to the IRS prior to closing, the transcript(s) must be used to validate the income documentation provided by the borrower and used in the underwriting process. In this case, because the lender has already received the tax transcript(s), an additional signed IRS Form 4506-T is not required to be obtained from the borrower.

When all of a borrower's income is validated by the DU validation service, the lender is not required to obtain a signed IRS Form 4506-T for that borrower.

### Use of IRS Forms to Obtain Federal Income Tax Information

When federal income tax information is used to document income for qualifying purposes, the lender may obtain transcripts of the applicable federal income tax documents. For example, the lender may obtain Tax Return Transcripts for Form 1040 or Wage and Income Transcripts for W2s, 1098s, and 1099s. However, in certain instances, copies of the actual returns, schedules, or forms are needed because the tax return transcripts will not provide the detail required to qualify the borrower. For example, the lender must obtain copies of Schedules B through F, Schedule K-1, or business returns. These schedules or forms are not required if:

- the income reflected on the applicable schedule transcripts is positive, and
- the income supported by that schedule or form is not being used for qualifying.

If a borrower's self-employment income from a sole proprietorship (as reported on IRS Form 1040, Schedule C or C-EZ) is validated by the DU validation service, lenders are not required to obtain the tax returns. Documentation in accordance with the DU message is acceptable. The DU message may allow a tax transcript rather than the tax returns. See B3-2-02, DU Validation Service (10/07/2020), for additional information.

### Alternatives to the IRS Form 4506-T

Use of IRS Form 4506-T has become the most efficient method for lenders to obtain electronic transcripts of the borrower's income tax information. It is also acceptable for lenders to use either *IRS Request for Copy of Tax Return* (IRS Form 4506) or *IRS Tax Information Authorization* (IRS Form 8821); however, these forms are not supported electronically by the IRS. In addition, *IRS Short Form Request for Individual Tax Return Transcript* (IRS Form 4506T-EZ) is also acceptable, although it may only be used to obtain transcripts of IRS Form 1040 (no other tax forms are supported using IRS Form 4506T-EZ).

**Note:** Borrowers with income from Puerto Rico must use Modelo SC 2907 (Solicitud De Copia De Planilla, Relevo De Herencia Y De Donacion) rather than one of the forms mentioned above. Applicable forms or processes for eligible borrowers filing tax returns in other U.S. territories must be adhered to and obtained when required.

### Completing and Submitting the IRS Authorization Form

IRS Form 4506-T can be used to obtain transcripts for up to four years or tax periods but only one tax form number can be requested per each IRS Form 4506-T. For example, it is necessary to complete two IRS Form 4506-Ts for a self-employed borrower whose income documentation includes both two years of personal tax returns and two years of business tax returns. One IRS Form 4506-T will be required to obtain a transcript of the personal 1040 returns and another will be required for the business returns (Form 1065, Form 1120, Form 1120A, etc.).

Lenders must

- fill in as the recipient of the tax documents — either its name or the name of the servicer, if servicing will be transferred within 120 days of the taxpayer signing the form;
- indicate that the request is for documentation concerning the year or years for which the borrower's income was or will be used in underwriting the loan; and
- date the form(s) with the date on which the borrower signs the form (or ascertain that the borrower dates the form when he or she signs it).

IRS Forms 4506-T and 4506 are valid for 120 days after completion (including signature) by the borrower. IRS Form 8821 is valid for 60 days after completion.

**Note:** The borrower should not be required to sign an IRS authorization form before all items on the form, including the transcript being requested, the years/tax periods, and the date, have been completed.

### Retaining the Tax Documents

All tax documents, including either the IRS Form 4506-T or the tax transcript(s) received from the IRS, and any subsequent explanation or documentation of discrepancies must be retained in the loan file for QC review.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-06	July 03, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2017-02	February 28, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2013-05	July 30, 2013
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-06	April 30, 2010

**B3-3.1-06, Requirements and Uses of IRS IVES Request for Transcript of Tax Return Form 4506-C (12/16/2020)****Introduction**

The IRS Form 4506-C is a form that can be utilized by authorized IRS Income Verification Express Service (IVES) participants to order tax transcripts electronically with the consent of the taxpayer. This topic contains information on the use of *IRS IVES Request for Transcript of Tax Return* (IRS Form 4506-C), including:

- Use of IRS Form 4506-C to Validate Borrower Income Documentation
- Use of IRS Forms to Obtain Federal Income Tax Information
- Completing and Submitting the IRS Authorization Form
- Retaining the Tax Documents

**Use of IRS Form 4506-C to Validate Borrower Income Documentation**

Fannie Mae requires lenders to have each borrower whose income (regardless of income source) is used to qualify for the loan to complete and sign a separate IRS Form 4506-C at or before closing. An alternate form is also acceptable if it authorizes the release of comparable tax information from the IRS. As noted below, it may be necessary to have the borrower complete and sign multiple IRS Form 4506-Cs depending on the transcripts required to validate the income.

**Note:** Borrowers with income from Puerto Rico must use Modelo SC 2907 (Solicitud De Copia De Planilla, Relevé De Herencia Y De Donación) rather than IRS Form 4506-C. Applicable forms or processes for eligible borrowers filing tax returns in other U.S. territories must be adhered to and obtained when required.

In addition, the lender must document the requirement to obtain tax transcripts by submitting the IRS Form 4506-C to the IRS (directly or through an authorized designee) in their written quality control (QC) plan. See D1-3-02, Lender Post-Closing Quality Control Review of Approval Conditions, Underwriting Decisions, and Documentation (12/16/2020) for details concerning QC requirements.

If the lender submits the IRS Form 4506-C to the IRS prior to closing, the transcript(s) must be used to validate the income documentation provided by the borrower and used in the underwriting process. In this case, because the lender has already received the tax transcript(s), an additional signed IRS Form 4506-C is not required to be signed by the borrower.

When all of a borrower's income is validated by the DU validation service, the lender is not required to obtain a signed IRS Form 4506-C for that borrower.

**Use of IRS Forms to Obtain Federal Income Tax Information**

When federal income tax information is used to document income for qualifying purposes, the lender may obtain transcripts of the applicable federal income tax documents. For example, the lender may obtain Tax Return Transcripts for Form 1040 or Wage and Income Transcripts for W2s, 1098s, and 1099s. However, in certain instances, copies of the actual returns, schedules, or forms are needed because the tax return transcripts will not provide the detail required to qualify the borrower. For example, the lender must obtain copies of Schedules B through F, Schedule K-1, or business returns. These schedules or forms are not required if:

- the income reflected on the applicable schedule transcripts is positive, and
- the income supported by that schedule or form is not being used for qualifying.

If a borrower's self-employment income from a sole proprietorship (as reported on IRS Form 1040, Schedule C or C-EZ) is validated by the DU validation service, lenders are not required to obtain the tax returns. Documentation in accordance with the DU message is acceptable. The DU message may allow a tax transcript rather than the tax returns. See B3-2-02, DU Validation Service (10/07/2020), for additional information.

**Completing and Submitting the IRS Authorization Form**

IRS Form 4506-C can be used to obtain transcripts for up to four years or tax periods but only one tax form number can be requested per each IRS Form 4506-C. For example, it is necessary to complete two IRS Form 4506-Cs for a self-employed borrower whose income documentation includes both two years of personal tax returns and two years of business tax returns. One IRS Form 4506-C will be required to obtain a transcript of the personal 1040 returns and another will be required for the business returns (Form 1065, Form 1120, Form 1120A, etc.).

Lenders must

- fill in as the recipient of the tax documents — either its name or the name of the servicer, if servicing will be transferred within 120 days of the taxpayer signing the form;
- indicate that the request is for documentation concerning the year or years for which the borrower's income was or will be used in underwriting the loan; and
- date the form(s) with the date on which the borrower signs the form (or ascertain that the borrower dates the form when he or she signs it).

IRS Form 4506-C is valid for 120 days after completion (including signature) by the borrower.

**Note:** The borrower should not be required to sign an IRS authorization form before all items on the form, including the transcript being requested, the years/tax periods, and the date, have been completed.

**Retaining the Tax Documents**

All tax documents, including either the IRS Form 4506-C or the tax transcript(s) received from the IRS, and any subsequent explanation or documentation of discrepancies must be retained in the loan file for QC review.

**Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020

Announcement SEL-2019-06	July 03, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2017-02	February 28, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2013-05	July 30, 2013
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2010-06	April 30, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-07, Verbal Verification of Employment (10/02/2018)

### B3-3.1-07, Verbal Verification of Employment (10/02/2018)

#### Introduction

This topic contains information on verbal verification of employment requirements for all borrowers.

#### Verbal Verification of Employment

Lenders must obtain a verbal verification of employment (verbal VOE) for each borrower using employment or self-employment income to qualify. The verbal VOE must be obtained within 10 business days prior to the note date for employment income, and within 120 calendar days prior to the note date for self-employment income. The verbal VOE requirement is intended to help lenders mitigate risk by confirming, as late in the process as possible, that the borrower remains employed as originally disclosed on the loan application. A change in the borrower's employment status could have a significant impact on that borrower's capacity to repay the mortgage loan and must be fully reevaluated.

Alternatively, lenders may obtain the verbal VOE after closing, up to the time of loan delivery. If the verbal VOE cannot be obtained prior to delivery, the loan is ineligible for delivery to Fannie Mae.

**Note:** If the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower "employed." See B3-3.1-09, Other Sources of Income (12/16/2020), for details on temporary leave.

The following table describes verbal VOE requirements:

Type of Income	Verbal VOE Requirements
<b>Hourly, Salary, and Commission Income (Non-Military)</b>	<p>Requirements:</p> <ul style="list-style-type: none"> <li>The lender must independently obtain a phone number and, if possible, an address for the borrower's employer. This can be accomplished by using a telephone book, the Internet, directory assistance, or by contacting the applicable licensing bureau.</li> <li>The lender must contact the employer verbally and confirm the borrower's current employment status within 10 business days prior to the note date. <b>Note:</b> If the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower "employed." See B3-3.1-09, Other Sources of Income (12/16/2020), for details on temporary leave.</li> <li>The conversation must be documented. It should include the following: <ul style="list-style-type: none"> <li>name and title of the person who confirmed the employment for the lender,</li> <li>name and title of the person who completed the verification for the employer,</li> <li>date of the call, and</li> <li>the source of the phone number.</li> </ul> </li> </ul> <p>Exceptions:</p> <ul style="list-style-type: none"> <li>If the employer will not verbally verify employment, the lender can obtain a written verification (other than an additional paystub) confirming the borrower's current employment status within the same time frame as the verbal VOE requirements. The written documentation must include the name and title of the person who completed the verification for the employer.</li> <li>If the borrower is a union member who works in an occupation that results in a series of short-term job assignments (such as a skilled construction worker, longshoreman, or stagehand), and the union facilitates the borrower's placement in each assignment, the lender may obtain the verbal VOE from the union.</li> <li>If the employer uses a third party employment verification vendor, the lender must obtain written verification from the vendor of the borrower's current employment status within the same time frame as the verbal VOE requirements.</li> </ul> <p><b>Note:</b> Because third-party vendor databases are typically updated monthly, the verification must evidence that the information in the vendor's database was no more than 35 days old as of the note date.</p> <p>When employment is validated by DU, DU includes in its assessment the age of the information in the vendor's database. The DU message will include a date by which the loan must close. This may differ from the age of data and 10 business day requirements above.</p>

	Compliance with the DU message satisfies the requirement for completing the verification of employment. See B3-2-02, DU Validation Service (10/07/2020) for additional information.
<b>Military Personnel</b>	<p>If the borrower is in the military, in lieu of a verbal or written VOE, the lender must obtain either</p> <ul style="list-style-type: none"> <li>• a military Leave and Earnings Statement dated within 30 calendar days prior to the note date (or 31 days for longer months), or</li> <li>• a verification of employment through the Defense Manpower Data Center (<a href="https://www.dmdc.osd.mil/appj/mla/">https://www.dmdc.osd.mil/appj/mla/</a>).</li> </ul>
<b>Self-Employed Income</b>	<p>Requirements:</p> <ul style="list-style-type: none"> <li>• The lender must verify the existence of the borrower's business within 120 calendar days prior to the note date <ul style="list-style-type: none"> <li>– from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau, if possible; or</li> <li>– by verifying a phone listing and address for the borrower's business using a telephone book, the Internet, or directory assistance.</li> </ul> </li> <li>• The lender must document the source of the information obtained and the name and title of the lender's employee who obtained the information.</li> </ul>

## Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2018-08	October 02, 2018
Announcement SEL-2016-09	December 6, 2016
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2013-06	August 20, 2013
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-08, Rental Income (06/03/2020)

### REVISION HISTORY 02/05/2020

REVISION NUMBER: 02052020      DATE: 02/05/2020

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-3.1-08, Rental Income (02/05/2020)

### Introduction

This topic provides information on qualifying a borrower's rental income, including:

- Associated Policies
- Eligible Properties
- Ineligible Properties
- General Requirements for Documenting Rental Income
- Documenting Rental Income from Subject Property
- Documenting Rental Income From Property Other Than the Subject Property
- Reconciling Partial or No Rental History on Tax Returns
- Calculating Monthly Qualifying Rental Income (or Loss)
- Treatment of the Income (or Loss)
- Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation
- Rental Income Calculation Worksheets
- Reporting of Gross Monthly Rent

### Associated Policies

In conjunction with the policies in this topic, lenders must also comply with, as applicable, but not limited to, the policies in the following:

- B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019);
- B3-3.1-01, General Income Information (08/07/2019) (Continuity of Income);
- B3-3.5-02, Income From Rental Property in DU (10/02/2019);
- B3-4.1-01, Minimum Reserve Requirements (08/07/2019); and

- B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

### Eligible Properties

Rental income is an acceptable source of stable income if it can be established that the income is likely to continue. If the rental income is derived from the subject property, the property must be one of the following:

- a two- to four-unit principal residence property in which the borrower occupies one of the units, or
- a one- to four-unit investment property.

If the income is derived from a property that is not the subject property, there are no restrictions on the property type. For example, rental income from a commercial property owned by the borrower is acceptable if the income otherwise meets all other requirements (it can be documented in accordance with the requirements below).

### Ineligible Properties

Generally, rental income from the borrower's principal residence (a one-unit principal residence or the unit the borrower occupies in a two- to four-unit property) or a second home cannot be used to qualify the borrower. However, Fannie Mae does allow certain exceptions to this policy for boarder income and properties with accessory units. See B3-3.1-09, Other Sources of Income (10/02/2019), for boarder income requirements, and B5-6-03, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for accessory unit income requirements.

### General Requirements for Documenting Rental Income

If a borrower has a history of renting the subject or another property, generally the rental income will be reported on IRS Form 1040, Schedule E of the borrower's personal tax returns or on Rental Real Estate Income and Expenses of a Partnership or an S Corporation form (IRS Form 8825) of a business tax return. If the borrower does not have a history of renting the subject property or if, in certain cases, the tax returns do not accurately reflect the ongoing income and expenses of the property, the lender may be justified in using a fully executed current lease agreement. Examples of scenarios that justify the use of a lease agreement are

- purchase transactions;
- refinance transactions in which the borrower purchased the rental property during or subsequent to the last tax return filing; or
- refinance transactions of a property that experienced significant rental interruptions such that income is not reported on the recent tax return (for example, major renovation to a property occurred in the prior year that affected rental income).

When the subject property will generate rental income and it is used for qualifying purposes, one of the following Fannie Mae forms must be used to support the income-earning potential of the property:

- For one-unit properties: *Single-Family Comparable Rent Schedule* (Form 1007) (provided in conjunction with the applicable appraisal report), or
- For two- to four-unit properties: *Small Residential Income Property Appraisal Report* (Form 1025).

### Documenting Rental Income from Subject Property

The lender must obtain documentation that is used to calculate the monthly rental income for qualifying purposes. The documentation may vary depending on whether the borrower has a history of renting the property, and whether the prior year tax return includes the income.

Does the Borrower Have a History of Receiving Rental Income From the Subject Property?	Transaction Type	Documentation Requirements
Yes	Refinance	Form 1007 or Form 1025, as applicable, and either <ul style="list-style-type: none"> <li>• the borrower's most recent year of signed federal income tax returns, including Schedule 1 and Schedule E, or</li> <li>• copies of the current lease agreement(s) if the borrower can document a qualifying exception (see Partial or No Rental History on Tax Returns below).</li> </ul>
No	Purchase	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> <li>• copies of the current lease agreement(s).</li> </ul> If the property is not currently rented, lease agreements are not required and Form 1007 or Form 1025 may be used. If there is a lease on the property that is being transferred to the borrower, the lender must verify that it does not contain any provisions that could affect Fannie Mae's first lien position on the property. See B7-2-05, Title Exceptions and Impediments (02/06/2019), for additional information.
No	Refinance	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> <li>• copies of the current lease agreement(s).</li> </ul>

If the borrower is not using any rental income from the subject property to qualify, the gross monthly rent must still be documented for lender reporting purposes.

### Documenting Rental Income From Property Other Than the Subject Property

When the borrower owns property – other than the subject property – that is rented, the lender must document the monthly gross (and net) rental income with the borrower's most recent signed federal income tax return that includes Schedule 1 and Schedule E. Copies of the current lease agreement(s) may be substituted if the borrower can document a qualifying exception. See *Reconciling Partial or No Rental History on Tax Returns* below.

**Reconciling Partial or No Rental History on Tax Returns**

In order for the lender to determine qualifying rental income, the lender must determine whether or not the rental property was in service for the entire tax year or only a portion of the year. In some situations, the lender’s analysis may determine that using alternative rental income calculations or using lease agreements to calculate income are more appropriate methods for calculating the qualifying income from rental properties. This policy may be applied to refinances of a subject rental property or to other rental properties owned by the borrower.

If the borrower is able to document (per the table below) that the rental property was not in service the previous tax year, or was in service for only a portion of the previous tax year, the lender may determine qualifying rental income by using

- Schedule E income and expenses, and annualizing the income (or loss) calculation; or
- fully executed lease agreement(s) to determine the gross rental income to be used in the net rental income (or loss) calculation.

If ...	Then ...
the property was acquired during or subsequent to the most recent tax filing year,	the lender must confirm the purchase date using the settlement statement or other documentation. <ul style="list-style-type: none"> <li>• If acquired during the year, Schedule E (Fair Rental Days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental).</li> <li>• If acquired after the last tax filing year, Schedule E will not reflect rental income or expenses for this property.</li> </ul>
the rental property was out of service for an extended period,	<ul style="list-style-type: none"> <li>• Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service.</li> <li>• Schedule E (Fair Rental Days) will confirm the number of days that the rental unit was in service, which must support the unit being out of service for all or a portion of the year.</li> </ul>
the lender determines that some other situation warrants an exception to use a lease agreement,	the lender must provide an explanation and justification in the loan file.

If the borrower is converting a principal residence to an investment property, see B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015), for guidance in using that rental income to qualify the borrower.

**Calculating Monthly Qualifying Rental Income (or Loss)**

To determine the amount of rental income from the subject property that can be used for qualifying purposes when the borrower is purchasing or refinancing a two- to four-unit principal residence or one- to four-unit investment property, the lender must consider the following:

If the borrower...	Then for qualifying purposes...
<ul style="list-style-type: none"> <li>• currently owns a principal residence (or has a current housing expense), and</li> <li>• has at least a one-year history of receiving rental income or documented property management experience</li> </ul>	there is no restriction on the amount of rental income that can be used.
<ul style="list-style-type: none"> <li>• currently owns a principal residence (or has a current housing expense), and</li> <li>• has less than one-year history of receiving rental income or documented property management experience</li> </ul>	<ul style="list-style-type: none"> <li>• for a principal residence, rental income in an amount not exceeding PITIA of the subject property can be added to the borrower’s gross income, or</li> <li>• for an investment property, rental income can only be used to offset the PITIA of the subject property.</li> </ul>
<ul style="list-style-type: none"> <li>• does not own a principal residence, and</li> <li>• does not have a current housing expense</li> </ul>	rental income from the subject property cannot be used.

The lender must establish a history of property management experience by obtaining one of the following:

- The borrower’s most recent signed federal income tax return, including Schedules 1 and E. Schedule E should reflect rental income received for any property and Fair Rental Days of 365;
- If the property has been owned for at least one year, but there are less than 365 Fair Rental Days on Schedule E, a current signed lease agreement may be used to supplement the federal income tax return; or
- A current signed lease may be used to supplement a federal income tax return if the property was out of service for any time period in the prior year. Schedule E must support this by reflecting a reduced number of days in use and related repair costs. Form 1007 or Form 1025 must support the income reflected on the lease.

The lender must document the borrower has at least a one-year history of receiving rental income in accordance with *Documenting Rental Income From Property Other Than the Subject Property* above.

**Note:** This policy does not apply to HomeReady loans with rental income from an accessory unit.

**Method for Calculating the Income**

The method for calculating rental income (or loss) for qualifying purposes is dependent upon the documentation that is being used.

*Federal Income Tax Returns, Schedule E.* When Schedule E is used to calculate qualifying rental income, the lender must add back any listed depreciation, interest, homeowners’ association dues, taxes, or insurance expenses to the borrower’s cash flow. Non-recurring property expenses may be added back, if documented accordingly.

If the property was in service

- for the entire tax year, the rental income must be averaged over 12 months; or
- for less than the full year, the rental income must be averaged over the number of months that the borrower used the property as a rental unit.

See Treatment of the Income (or Loss) below for further instructions.

*Lease Agreements or Form 1007 or Form 1025.* When current lease agreements or market rents reported on Form 1007 or Form 1025 are used, the lender must calculate the rental income by multiplying the gross monthly rent(s) by 75%. (This is referred to as "Monthly Market Rent" on the Form 1007.) The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.

See Treatment of the Income (or Loss) below for further instructions.

### Treatment of the Income (or Loss)

The amount of monthly qualifying rental income (or loss) that is considered as part of the borrower's total monthly income (or loss) — and its treatment in the calculation of the borrower's total debt-to-income ratio — varies depending on whether the borrower occupies the rental property as his or her principal residence.

If the rental income relates to the borrower's principal residence:

- The monthly qualifying rental income (as defined above) must be added to the borrower's total monthly income. (The income is not netted against the PITIA of the property.)
- The full amount of the mortgage payment (PITIA) must be included in the borrower's total monthly obligations when calculating the debt-to-income ratio.

If the rental income (or loss) relates to a property other than the borrower's principal residence:

- If the monthly qualifying rental income (as defined above) minus the full PITIA is positive, it must be added to the borrower's total monthly income.
- If the monthly qualifying rental income minus PITIA is negative, the monthly net rental loss must be added to the borrower's total monthly obligations.
- The full PITIA for the rental property is factored into the amount of the net rental income (or loss); therefore, it should not be counted as a monthly obligation.
- The full monthly payment for the borrower's principal residence (full PITIA or monthly rent) must be counted as a monthly obligation.

### Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation

If the borrower is personally obligated on the mortgage debt (as evidenced by inclusion of the related mortgage(s) on the credit report) and gross rents and related expenses are reported through a partnership or S corporation, the business tax returns may be used to offset the property's PITIA. The steps described below should be followed:

1. Obtain the borrower's business tax returns, including IRS Form 8825 for the most recent year.
2. Evaluate each property listed on Form 8825, as shown below:
  - From total gross rents, subtract total expenses. Then add back insurance, mortgage interest, taxes, homeowners' association dues (if applicable), depreciation, and non-recurring property expenses (if documented accordingly).
  - Divide by the number of months the property was in service.
  - Subtract the entire PITIA (proposed for subject property or actual for real estate owned) to determine the monthly property cash flow.
3. If the resulting net cash flow is **positive**, the lender may exclude the property PITIA from the borrower's monthly obligations when calculating the debt-to-income ratio.
4. If the resulting net cash flow is **negative** (that is, the rental income derived from the investment property is not sufficient to fully offset the property PITIA), the calculated negative amount must be included in the borrower's monthly obligations when calculating the debt-to-income ratio.

In order to include a positive net rental income received through a partnership or an S corporation in the borrower's monthly qualifying income, the lender must evaluate it according to Fannie Mae's guidelines for income received from a partnership or an S corporation. See B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019) and B3-3.4-02, Analyzing Returns for an S Corporation (06/05/2019).

**Note:** For DU loan casefiles, the term "subject net cash flow" applies to net rental income from the subject property, and the term "net rental income" applies to rental income from properties other than the subject property.

### Rental Income Calculation Worksheets

Fannie Mae publishes four worksheets that lenders may use to calculate rental income. Use of these worksheets is optional. The worksheets are:

- Rental Income Worksheet – Principal Residence, 2- to 4-unit Property (Form 1037),
- Rental Income Worksheet – Individual Rental Income from Investment Property(s) (up to 4 properties) (Form 1038),
- Rental Income Worksheet – Individual Rental Income from Investment Property(s) (up to 10 properties) (Form 1038A), and
- Rental Income Worksheet – Business Rental Income from Investment Property(s) (Form 1039).

### Reporting of Gross Monthly Rent

Eligible rents on the subject property (gross monthly rent) must be reported to Fannie Mae in the loan delivery data for all two- to four-unit principal residence properties and investment properties, regardless of whether the borrower is using rental income to qualify for the loan. If the borrower is using rental income from the subject property to qualify for the loan, the requirements above must be followed to document and calculate the income.

If the borrower is not using any rental income from the subject property to qualify, gross monthly rent must be documented only for lender reporting purposes. The borrower can provide one of the sources listed above, or may provide one of the following sources (listed in order of preference):

- the appraisal report for a one-unit investment property or two- to four-unit property, or *Single-Family Comparable Rent Schedule* (Form

- 1007), provided neither the applicable appraisal nor Form 1007 is dated 12 months or more prior to the date of the note;
- if the property is not currently rented, the lender may use the opinion of market rents provided by the appraiser; or
- if an appraisal or Form 1007 is not required for the transaction, the lender may rely upon either a signed lease from the borrower or may obtain a statement from the borrower of the gross monthly rent being charged (or to be charged) for the property. The monthly rental amounts must be stated separately for each unit in a two- to four-unit property. The disclosure from the borrower must be in the form of one of the following:
  - a written statement from the borrower, or
  - an addition to the *Uniform Residential Loan Application* (Form 1003).

The lender must retain the documentation in the loan file that was relied upon to determine the amount of eligible rent reported.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2019-05	June 05, 2019
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-02	February 28, 2017
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2014-13	November 10, 2014
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-10	September 27, 2011
Announcement -2009-32	October 30, 2009

#### REVISION HISTORY 10/02/2019

REVISION NUMBER: 10022019 DATE: 10/02/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-3.1-08, Rental Income (10/02/2019)

#### Introduction

This topic provides information on qualifying a borrower's rental income, including:

- Associated Policies
- Eligible Properties
- Ineligible Properties
- General Requirements for Documenting Rental Income
- Documenting Rental Income from Subject Property
- Documenting Rental Income From Property Other Than the Subject Property
- Reconciling Partial or No Rental History on Tax Returns
- Calculating Monthly Qualifying Rental Income (or Loss)
- Treatment of the Income (or Loss)
- Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation
- Rental Income Calculation Worksheets
- Reporting of Gross Monthly Rent

#### Associated Policies

In conjunction with the policies in this topic, lenders must also comply with, as applicable, but not limited to, the policies in the following:

- B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019);
- B3-3.1-01, General Income Information (08/07/2019) (Continuity of Income);
- B3-3.5-02, Income From Rental Property in DU (10/02/2019);
- B3-4.1-01, Minimum Reserve Requirements (08/07/2019); and
- B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

#### Eligible Properties

Rental income is an acceptable source of stable income if it can be established that the income is likely to continue. If the rental income is derived from the subject property, the property must be one of the following:

- a two- to four-unit principal residence property in which the borrower occupies one of the units, or
- a one- to four-unit investment property.

If the income is derived from a property that is not the subject property, there are no restrictions on the property type. For example, rental income from a commercial property owned by the borrower is acceptable if the income otherwise meets all other requirements (it can be

documented in accordance with the requirements below).

**Ineligible Properties**

Generally, rental income from the borrower’s principal residence (a one-unit principal residence or the unit the borrower occupies in a two- to four-unit property) or a second home cannot be used to qualify the borrower. However, Fannie Mae does allow certain exceptions to this policy for boarder income and properties with accessory units. See B3-3.1-09, Other Sources of Income (10/02/2019), for boarder income requirements, and B5-6-03, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for accessory unit income requirements.

**General Requirements for Documenting Rental Income**

If a borrower has a history of renting the subject or another property, generally the rental income will be reported on IRS Form 1040, Schedule E of the borrower’s personal tax returns or on Rental Real Estate Income and Expenses of a Partnership or an S Corporation form (IRS Form 8825) of a business tax return. If the borrower does not have a history of renting the subject property or if, in certain cases, the tax returns do not accurately reflect the ongoing income and expenses of the property, the lender may be justified in using a fully executed current lease agreement. Examples of scenarios that justify the use of a lease agreement are

- purchase transactions;
- refinance transactions in which the borrower purchased the rental property during or subsequent to the last tax return filing; or
- refinance transactions of a property that experienced significant rental interruptions such that income is not reported on the recent tax return (for example, major renovation to a property occurred in the prior year that affected rental income).

When the subject property will generate rental income and it is used for qualifying purposes, one of the following Fannie Mae forms must be used to support the income-earning potential of the property:

- For one-unit properties: *Single-Family Comparable Rent Schedule* (Form 1007) (provided in conjunction with the applicable appraisal report), or
- For two- to four-unit properties: *Small Residential Income Property Appraisal Report* (Form 1025).

**Documenting Rental Income from Subject Property**

The lender must obtain documentation that is used to calculate the monthly rental income for qualifying purposes. The documentation may vary depending on whether the borrower has a history of renting the property, and whether the prior year tax return includes the income.

Does the Borrower Have a History of Receiving Rental Income From the Subject Property?	Transaction Type	Documentation Requirements
Yes	Refinance	Form 1007 or Form 1025, as applicable, and either <ul style="list-style-type: none"> <li>• the borrower’s most recent year of signed federal income tax returns, including Schedule 1 and Schedule E, or</li> <li>• copies of the current lease agreement(s) if the borrower can document a qualifying exception (see Partial or No Rental History on Tax Returns below).</li> </ul>
No	Purchase	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> <li>• copies of the current lease agreement(s).</li> </ul> If the property is not currently rented, lease agreements are not required and Form 1007 or Form 1025 may be used. If there is a lease on the property that is being transferred to the borrower, the lender must verify that it does not contain any provisions that could affect Fannie Mae’s first lien position on the property. See B7-2-05, Title Exceptions and Impediments (02/06/2019), for additional information.
No	Refinance	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> <li>• copies of the current lease agreement(s).</li> </ul>

If the borrower is not using any rental income from the subject property to qualify, the gross monthly rent must still be documented for lender reporting purposes.

**Documenting Rental Income From Property Other Than the Subject Property**

When the borrower owns property – other than the subject property – that is rented, the lender must document the monthly gross (and net) rental income with the borrower’s most recent signed federal income tax return that includes Schedule 1 and Schedule E. Copies of the current lease agreement(s) may be substituted if the borrower can document a qualifying exception. See *Reconciling Partial or No Rental History on Tax Returns* below.

**Reconciling Partial or No Rental History on Tax Returns**

In order for the lender to determine qualifying rental income, the lender must determine whether or not the rental property was in service for the entire tax year or only a portion of the year. In some situations, the lender’s analysis may determine that using alternative rental income calculations or using lease agreements to calculate income are more appropriate methods for calculating the qualifying income from rental properties. This policy may be applied to refinances of a subject rental property or to other rental properties owned by the borrower.

If the borrower is able to document (per the table below) that the rental property was not in service the previous tax year, or was in service for only a portion of the previous tax year, the lender may determine qualifying rental income by using

- Schedule E income and expenses, and annualizing the income (or loss) calculation; or
- fully executed lease agreement(s) to determine the gross rental income to be used in the net rental income (or loss) calculation.

If ...	Then ...
the property was acquired during or subsequent to the most recent tax filing year,	<p>the lender must confirm the purchase date using the settlement statement or other documentation.</p> <ul style="list-style-type: none"> <li>• If acquired during the year, Schedule E (Fair Rental Days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental).</li> <li>• If acquired after the last tax filing year, Schedule E will not reflect rental income or expenses for this property.</li> </ul>
the rental property was out of service for an extended period,	<ul style="list-style-type: none"> <li>• Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service.</li> <li>• Schedule E (Fair Rental Days) will confirm the number of days that the rental unit was in service, which must support the unit being out of service for all or a portion of the year.</li> </ul>
the lender determines that some other situation warrants an exception to use a lease agreement,	the lender must provide an explanation and justification in the loan file.

If the borrower is converting a principal residence to an investment property, see B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015), for guidance in using that rental income to qualify the borrower.

### Calculating Monthly Qualifying Rental Income (or Loss)

To determine the amount of rental income from the subject property that can be used for qualifying purposes when the borrower is purchasing a two- to four-unit principal residence or one- to four-unit investment property, the lender must consider the following:

If the borrower...	Then for qualifying purposes...
<ul style="list-style-type: none"> <li>• currently owns a principal residence (or has a current housing expense), and</li> <li>• has at least a one-year history of rental income or documented property management experience</li> </ul>	there is no restriction on the amount of rental income that can be used.
<ul style="list-style-type: none"> <li>• currently owns a principal residence (or has a current housing expense), and</li> <li>• has less than one-year history of receiving rental income or documented property management experience</li> </ul>	<ul style="list-style-type: none"> <li>• for a principal residence, rental income in an amount not exceeding the PITIA of the subject property can be added to the borrower's gross income, or</li> <li>• for an investment property, rental income can only be used to offset the PITIA of the subject property.</li> </ul>
<ul style="list-style-type: none"> <li>• does not own a principal residence, and</li> <li>• does not have a current housing expense</li> </ul>	rental income for the subject property cannot be used.

The lender must establish a history of property management experience by obtaining one of the following:

- The borrower's most recent signed federal income tax return, including Schedules 1 and E. Schedule E should reflect rental income received for any property and Fair Rental Days of 365;
- If the property has been owned for at least one year, but there are less than 365 Fair Rental Days on Schedule E, a current signed lease agreement may be used to supplement the federal income tax return; or
- A current signed lease may be used to supplement a federal income tax return if the property was out of service for any time period in the prior year. Schedule E must support this by reflecting a reduced number of days in use and related repair costs. Form 1007 or Form 1025 must support the income reflected on the lease.

The lender must document the borrower has at least a one-year history of receiving rental income in accordance with *Documenting Rental Income From Property Other Than the Subject Property* above.

**Note:** This policy does not apply to HomeReady loans with rental income from an accessory unit.

#### Method for Calculating the Income

The method for calculating rental income (or loss) for qualifying purposes is dependent upon the documentation that is being used.

*Federal Income Tax Returns, Schedule E.* When Schedule E is used to calculate qualifying rental income, the lender must add back any listed depreciation, interest, homeowners' association dues, taxes, or insurance expenses to the borrower's cash flow. Non-recurring property expenses may be added back, if documented accordingly.

If the property was in service

- for the entire tax year, the rental income must be averaged over 12 months; or
- for less than the full year, the rental income must be averaged over the number of months that the borrower used the property as a rental unit.

See Treatment of the Income (or Loss) below for further instructions.

*Lease Agreements or Form 1007 or Form 1025.* When current lease agreements or market rents reported on Form 1007 or Form 1025 are used, the lender must calculate the rental income by multiplying the gross monthly rent(s) by 75%. (This is referred to as "Monthly Market Rent" on the Form 1007.) The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.

See Treatment of the Income (or Loss) below for further instructions.

### Treatment of the Income (or Loss)

The amount of monthly qualifying rental income (or loss) that is considered as part of the borrower's total monthly income (or loss) — and its treatment in the calculation of the borrower's total debt-to-income ratio — varies depending on whether the borrower occupies the rental property as his or her principal residence.

If the rental income relates to the borrower's principal residence:

- The monthly qualifying rental income (as defined above) must be added to the borrower's total monthly income. (The income is not netted against the PITIA of the property.)
- The full amount of the mortgage payment (PITIA) must be included in the borrower's total monthly obligations when calculating the debt-to-income ratio.

If the rental income (or loss) relates to a property other than the borrower's principal residence:

- If the monthly qualifying rental income (as defined above) minus the full PITIA is positive, it must be added to the borrower's total monthly income.
- If the monthly qualifying rental income minus PITIA is negative, the monthly net rental loss must be added to the borrower's total monthly obligations.
- The full PITIA for the rental property is factored into the amount of the net rental income (or loss); therefore, it should not be counted as a monthly obligation.
- The full monthly payment for the borrower's principal residence (full PITIA or monthly rent) must be counted as a monthly obligation.

### Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation

If the borrower is personally obligated on the mortgage debt (as evidenced by inclusion of the related mortgage(s) on the credit report) and gross rents and related expenses are reported through a partnership or S corporation, the business tax returns may be used to offset the property's PITIA. The steps described below should be followed:

1. Obtain the borrower's business tax returns, including IRS Form 8825 for the most recent year.
2. Evaluate each property listed on Form 8825, as shown below:
  - From total gross rents, subtract total expenses. Then add back insurance, mortgage interest, taxes, homeowners' association dues (if applicable), depreciation, and non-recurring property expenses (if documented accordingly).
  - Divide by the number of months the property was in service.
  - Subtract the entire PITIA (proposed for subject property or actual for real estate owned) to determine the monthly property cash flow.
3. If the resulting net cash flow is **positive**, the lender may exclude the property PITIA from the borrower's monthly obligations when calculating the debt-to-income ratio.
4. If the resulting net cash flow is **negative** (that is, the rental income derived from the investment property is not sufficient to fully offset the property PITIA), the calculated negative amount must be included in the borrower's monthly obligations when calculating the debt-to-income ratio.

In order to include a positive net rental income received through a partnership or an S corporation in the borrower's monthly qualifying income, the lender must evaluate it according to Fannie Mae's guidelines for income received from a partnership or an S corporation. See B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019) and B3-3.4-02, Analyzing Returns for an S Corporation (06/05/2019).

**Note:** For DU loan casefiles, the term "subject net cash flow" applies to net rental income from the subject property, and the term "net rental income" applies to rental income from properties other than the subject property.

### Rental Income Calculation Worksheets

Fannie Mae publishes four worksheets that lenders may use to calculate rental income. Use of these worksheets is optional. The worksheets are:

- Rental Income Worksheet – Principal Residence, 2- to 4-unit Property (Form 1037),
- Rental Income Worksheet – Individual Rental Income from Investment Property(s) (up to 4 properties) (Form 1038),
- Rental Income Worksheet – Individual Rental Income from Investment Property(s) (up to 10 properties) (Form 1038A), and
- Rental Income Worksheet – Business Rental Income from Investment Property(s) (Form 1039).

### Reporting of Gross Monthly Rent

Eligible rents on the subject property (gross monthly rent) must be reported to Fannie Mae in the loan delivery data for all two- to four-unit principal residence properties and investment properties, regardless of whether the borrower is using rental income to qualify for the loan. If the borrower is using rental income from the subject property to qualify for the loan, the requirements above must be followed to document and calculate the income.

If the borrower is not using any rental income from the subject property to qualify, gross monthly rent must be documented only for lender reporting purposes. The borrower can provide one of the sources listed above, or may provide one of the following sources (listed in order of preference):

- the appraisal report for a one-unit investment property or two- to four-unit property, or *Single-Family Comparable Rent Schedule* (Form 1007), provided neither the applicable appraisal nor Form 1007 is dated 12 months or more prior to the date of the note;
- if the property is not currently rented, the lender may use the opinion of market rents provided by the appraiser; or
- if an appraisal or Form 1007 is not required for the transaction, the lender may rely upon either a signed lease from the borrower or may obtain a statement from the borrower of the gross monthly rent being charged (or to be charged) for the property. The monthly rental amounts must be stated separately for each unit in a two- to four-unit property. The disclosure from the borrower must be in the form of one of the following:
  - a written statement from the borrower, or
  - an addition to the *Uniform Residential Loan Application* (Form 1003).

The lender must retain the documentation in the loan file that was relied upon to determine the amount of eligible rent reported.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2019-05	June 05, 2019
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-02	February 28, 2017
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2014-13	November 10, 2014
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-10	September 27, 2011
Announcement -2009-32	October 30, 2009

## B3-3.1-08, Rental Income (06/03/2020)

### Introduction

This topic provides information on qualifying a borrower's rental income, including:

- Associated Policies
- Eligible Properties
- Ineligible Properties
- General Requirements for Documenting Rental Income
- Documenting Rental Income from Subject Property
- Documenting Rental Income from Property Other Than the Subject Property
- Reconciling Partial or No Rental History on Tax Returns
- Calculating Monthly Qualifying Rental Income (or Loss)
- Treatment of the Income (or Loss)
- Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation
- Rental Income Calculation Worksheets
- Reporting of Gross Monthly Rent

### Associated Policies

In conjunction with the policies in this topic, lenders must also comply with, as applicable, but not limited to, the policies in the following:

- B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020);
- B3-3.1-01, General Income Information (12/16/2020) (Continuity of Income);
- B3-3.5-02, Income from Rental Property in DU (12/16/2020);
- B3-4.1-01, Minimum Reserve Requirements (10/07/2020); and
- B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

### Eligible Properties

Rental income is an acceptable source of stable income if it can be established that the income is likely to continue. If the rental income is derived from the subject property, the property must be one of the following:

- a two- to four-unit principal residence property in which the borrower occupies one of the units, or
- a one- to four-unit investment property.

If the income is derived from a property that is not the subject property, there are no restrictions on the property type. For example, rental income from a commercial property owned by the borrower is acceptable if the income otherwise meets all other requirements (it can be documented in accordance with the requirements below).

### Ineligible Properties

Generally, rental income from the borrower's principal residence (a one-unit principal residence or the unit the borrower occupies in a two- to four-unit property) or a second home cannot be used to qualify the borrower. However, Fannie Mae does allow certain exceptions to this policy for boarder income and properties with accessory units. See B3-3.1-09, Other Sources of Income (12/16/2020), for boarder income requirements, and B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for accessory unit income requirements.

### General Requirements for Documenting Rental Income

If a borrower has a history of renting the subject or another property, generally the rental income will be reported on IRS Form 1040, Schedule E of the borrower's personal tax returns or on Rental Real Estate Income and Expenses of a Partnership or an S Corporation form (IRS Form 8825) of a business tax return. If the borrower does not have a history of renting the subject property or if, in certain cases, the tax returns do not accurately reflect the ongoing income and expenses of the property, the lender may be justified in using a fully executed

current lease agreement. Examples of scenarios that justify the use of a lease agreement are

- purchase transactions;
- refinance transactions in which the borrower purchased the rental property during or subsequent to the last tax return filing; or
- refinance transactions of a property that experienced significant rental interruptions such that income is not reported on the recent tax return (for example, major renovation to a property occurred in the prior year that affected rental income).

When the subject property will generate rental income and it is used for qualifying purposes, one of the following Fannie Mae forms must be used to support the income-earning potential of the property:

- For one-unit properties: *Single-Family Comparable Rent Schedule* (Form 1007) (provided in conjunction with the applicable appraisal report), or
- For two- to four-unit properties: *Small Residential Income Property Appraisal Report* (Form 1025).

**Documenting Rental Income from Subject Property**

The lender must obtain documentation that is used to calculate the monthly rental income for qualifying purposes. The documentation may vary depending on whether the borrower has a history of renting the property, and whether the prior year tax return includes the income.

Does the Borrower Have a History of Receiving Rental Income From the Subject Property?	Transaction Type	Documentation Requirements
Yes	Refinance	Form 1007 or Form 1025, as applicable, and either <ul style="list-style-type: none"> <li>• the borrower’s most recent year of signed federal income tax returns, including Schedule 1 and Schedule E, or</li> <li>• copies of the current lease agreement(s) if the borrower can document a qualifying exception (see Partial or No Rental History on Tax Returns below).</li> </ul>
No	Purchase	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> <li>• copies of the current lease agreement(s).</li> </ul> If the property is not currently rented, lease agreements are not required and Form 1007 or Form 1025 may be used. If there is a lease on the property that is being transferred to the borrower, see B2-1.5-03, Legal Requirements (06/03/2020) B7-2-05, Title Exceptions and Impediments (12/16/2020), for additional information.
No	Refinance	Form 1007 or Form 1025, as applicable, and <ul style="list-style-type: none"> <li>• copies of the current lease agreement(s).</li> </ul>

If the borrower is not using any rental income from the subject property to qualify, the gross monthly rent must still be documented for lender reporting purposes.

**Documenting Rental Income from Property Other Than the Subject Property**

When the borrower owns property – other than the subject property – that is rented, the lender must document the monthly gross (and net) rental income with the borrower’s most recent signed federal income tax return that includes Schedule 1 and Schedule E. Copies of the current lease agreement(s) may be substituted if the borrower can document a qualifying exception. See *Reconciling Partial or No Rental History on Tax Returns* below.

**Reconciling Partial or No Rental History on Tax Returns**

In order for the lender to determine qualifying rental income, the lender must determine whether or not the rental property was in service for the entire tax year or only a portion of the year. In some situations, the lender’s analysis may determine that using alternative rental income calculations or using lease agreements to calculate income are more appropriate methods for calculating the qualifying income from rental properties. This policy may be applied to refinances of a subject rental property or to other rental properties owned by the borrower.

If the borrower is able to document (per the table below) that the rental property was not in service the previous tax year, or was in service for only a portion of the previous tax year, the lender may determine qualifying rental income by using

- Schedule E income and expenses, and annualizing the income (or loss) calculation; or
- fully executed lease agreement(s) to determine the gross rental income to be used in the net rental income (or loss) calculation.

If ...	Then ...
the property was acquired during or subsequent to the most recent tax filing year,	the lender must confirm the purchase date using the settlement statement or other documentation. <ul style="list-style-type: none"> <li>• If acquired during the year, Schedule E (Fair Rental Days) must confirm a partial year rental income and expenses (depending on when the unit was in service as a rental).</li> <li>• If acquired after the last tax filing year, Schedule E will not reflect rental income or expenses for this property.</li> </ul>
the rental property was out of service for an extended period,	<ul style="list-style-type: none"> <li>• Schedule E will reflect the costs for renovation or rehabilitation as repair expenses. Additional documentation may be required to ensure that the expenses support a significant renovation that supports the amount of time that the rental property was out of service.</li> </ul>

	<ul style="list-style-type: none"> <li>Schedule E (Fair Rental Days) will confirm the number of days that the rental unit was in service, which must support the unit being out of service for all or a portion of the year.</li> </ul>
the lender determines that some other situation warrants an exception to use a lease agreement,	the lender must provide an explanation and justification in the loan file.

If the borrower is converting a principal residence to an investment property, see B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015), for guidance in using that rental income to qualify the borrower.

### Calculating Monthly Qualifying Rental Income (or Loss)

To determine the amount of rental income from the subject property that can be used for qualifying purposes when the borrower is purchasing or refinancing a two- to four-unit principal residence or one- to four-unit investment property, the lender must consider the following:

If the borrower...	Then for qualifying purposes...
<ul style="list-style-type: none"> <li>currently owns a principal residence (or has a current housing expense), and</li> <li>has at least a one-year history of receiving rental income or documented property management experience</li> </ul>	there is no restriction on the amount of rental income that can be used.
<ul style="list-style-type: none"> <li>currently owns a principal residence (or has a current housing expense), and</li> <li>has less than one-year history of receiving rental income or documented property management experience</li> </ul>	<ul style="list-style-type: none"> <li>for a principal residence, rental income in an amount not exceeding PITIA of the subject property can be added to the borrower's gross income, or</li> <li>for an investment property, rental income can only be used to offset the PITIA of the subject property.</li> </ul>
<ul style="list-style-type: none"> <li>does not own a principal residence, and</li> <li>does not have a current housing expense</li> </ul>	rental income from the subject property cannot be used.

The lender must establish a history of property management experience by obtaining one of the following:

- The borrower's most recent signed federal income tax return, including Schedules 1 and E. Schedule E should reflect rental income received for any property and Fair Rental Days of 365;
- If the property has been owned for at least one year, but there are less than 365 Fair Rental Days on Schedule E, a current signed lease agreement may be used to supplement the federal income tax return; or
- A current signed lease may be used to supplement a federal income tax return if the property was out of service for any time period in the prior year. Schedule E must support this by reflecting a reduced number of days in use and related repair costs. Form 1007 or Form 1025 must support the income reflected on the lease.

The lender must document the borrower has at least a one-year history of receiving rental income in accordance with *Documenting Rental Income From Property Other Than the Subject Property* above.

**Note:** This policy does not apply to HomeReady loans with rental income from an accessory unit.

#### Method for Calculating the Income

The method for calculating rental income (or loss) for qualifying purposes is dependent upon the documentation that is being used.

*Federal Income Tax Returns, Schedule E.* When Schedule E is used to calculate qualifying rental income, the lender must add back any listed depreciation, interest, homeowners' association dues, taxes, or insurance expenses to the borrower's cash flow. Non-recurring property expenses may be added back, if documented accordingly.

If the property was in service

- for the entire tax year, the rental income must be averaged over 12 months; or
- for less than the full year, the rental income must be averaged over the number of months that the borrower used the property as a rental unit.

See Treatment of the Income (or Loss) below for further instructions.

**Lease Agreements or Form 1007 or Form 1025:** When current lease agreements or market rents reported on Form 1007 or Form 1025 are used, the lender must calculate the rental income by multiplying the gross monthly rent(s) by 75%. (This is referred to as "Monthly Market Rent" on the Form 1007.) The remaining 25% of the gross rent will be absorbed by vacancy losses and ongoing maintenance expenses.

See Treatment of the Income (or Loss) below for further instructions.

#### Treatment of the Income (or Loss)

The amount of monthly qualifying rental income (or loss) that is considered as part of the borrower's total monthly income (or loss) — and its treatment in the calculation of the borrower's total debt-to-income ratio — varies depending on whether the borrower occupies the rental property as his or her principal residence.

If the rental income relates to the borrower's principal residence:

- The monthly qualifying rental income (as defined above) must be added to the borrower's total monthly income. (The income is not netted against the PITIA of the property.)
- The full amount of the mortgage payment (PITIA) must be included in the borrower's total monthly obligations when calculating the debt-to-income ratio.

If the rental income (or loss) relates to a property other than the borrower's principal residence:

- If the monthly qualifying rental income (as defined above) minus the full PITIA is positive, it must be added to the borrower's total monthly

income.

- If the monthly qualifying rental income minus PITIA is negative, the monthly net rental loss must be added to the borrower's total monthly obligations.
- The full PITIA for the rental property is factored into the amount of the net rental income (or loss); therefore, it should not be counted as a monthly obligation.
- The full monthly payment for the borrower's principal residence (full PITIA or monthly rent) must be counted as a monthly obligation.

### Offsetting Monthly Obligations for Rental Property Reported through a Partnership or an S Corporation

If the borrower is personally obligated on the mortgage debt (as evidenced by inclusion of the related mortgage(s) on the credit report) and gross rents and related expenses are reported through a partnership or S corporation, the business tax returns may be used to offset the property's PITIA. The steps described below should be followed:

1. Obtain the borrower's business tax returns, including IRS Form 8825 for the most recent year.
2. Evaluate each property listed on Form 8825, as shown below:
  - From total gross rents, subtract total expenses. Then add back insurance, mortgage interest, taxes, homeowners' association dues (if applicable), depreciation, and non-recurring property expenses (if documented accordingly).
  - Divide by the number of months the property was in service.
  - Subtract the entire PITIA (proposed for subject property or actual for real estate owned) to determine the monthly property cash flow.
3. If the resulting net cash flow is **positive**, the lender may exclude the property PITIA from the borrower's monthly obligations when calculating the debt-to-income ratio.
4. If the resulting net cash flow is **negative** (that is, the rental income derived from the investment property is not sufficient to fully offset the property PITIA), the calculated negative amount must be included in the borrower's monthly obligations when calculating the debt-to-income ratio.

In order to include a positive net rental income received through a partnership or an S corporation in the borrower's monthly qualifying income, the lender must evaluate it according to Fannie Mae's guidelines for income received from a partnership or an S corporation. See B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019) and B3-3.4-02, Analyzing Returns for an S Corporation (06/05/2019).

### Rental Income Calculation Worksheets

Fannie Mae publishes four worksheets that lenders may use to calculate rental income. Use of these worksheets is optional. The worksheets are:

- Rental Income Worksheet – Principal Residence, 2- to 4-unit Property (Form 1037),
- Rental Income Worksheet – Individual Rental Income from Investment Property(s) (up to 4 properties) (Form 1038),
- Rental Income Worksheet – Individual Rental Income from Investment Property(s) (up to 10 properties) (Form 1038A), and
- Rental Income Worksheet – Business Rental Income from Investment Property(s) (Form 1039).

### Reporting of Gross Monthly Rent

Eligible rents on the subject property (gross monthly rent) must be reported to Fannie Mae in the loan delivery data for all two- to four-unit principal residence properties and investment properties, regardless of whether the borrower is using rental income to qualify for the loan. If the borrower is using rental income from the subject property to qualify for the loan, the requirements above must be followed to document and calculate the income.

If the borrower is not using any rental income from the subject property to qualify, gross monthly rent must be documented only for lender reporting purposes. The borrower can provide one of the sources listed above, or may provide one of the following sources (listed in order of preference):

- the appraisal report for a one-unit investment property or two- to four-unit property, or *Single-Family Comparable Rent Schedule* (Form 1007), provided neither the applicable appraisal nor Form 1007 is dated 12 months or more prior to the date of the note;
- if the property is not currently rented, the lender may use the opinion of market rents provided by the appraiser; or
- if an appraisal or Form 1007 is not required for the transaction, the lender may rely upon either a signed lease from the borrower or may obtain a statement from the borrower of the gross monthly rent being charged (or to be charged) for the property. The monthly rental amounts must be stated separately for each unit in a two- to four-unit property. The disclosure from the borrower must be in the form of one of the following:
  - a written statement from the borrower, or
  - an addition to the Form 1003.

The lender must retain the documentation in the loan file that was relied upon to determine the amount of eligible rent reported.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-03	June 03, 2020
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2019-05	June 05, 2019
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-02	February 28, 2017
Announcement SEL-2015-10	September 29, 2015

Announcement SEL-2014-13	November 10, 2014
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-10	September 27, 2011
Announcement -2009-32	October 30, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.1, Employment and Other Sources of Income > B3-3.1-09, Other Sources of Income (12/16/2020)

REVISION HISTORY 10/02/2019

REVISION NUMBER: 10022019 DATE: 10/02/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-3.1-09, Other Sources of Income (10/02/2019)

#### Introduction

This topic provides information on documenting and qualifying a borrower's income from sources other than wages and salaries, including:

- Documentation Requirements for Current Receipt of Income
- Alimony or Child Support
- Automobile Allowance
- Boarder Income
- Capital Gains Income
- Disability Income – Long-Term
- Employment Offers or Contracts
- Employment-Related Assets as Qualifying Income
- Foreign Income
- Foster-Care Income
- Housing or Parsonage Allowance
- Interest and Dividends Income
- Mortgage Credit Certificates
- Mortgage Differential Payments Income
- Non-Occupant Borrower Income
- Notes Receivable Income
- Public Assistance Income
- Retirement, Government Annuity, and Pension Income
- Royalty Payment Income
- Schedule K-1 Income
- Social Security Income
- Temporary Leave Income
- Tip Income
- Trust Income
- Unemployment Benefits Income
- VA Benefits Income

#### Documentation Requirements for Current Receipt of Income

The documentation required for each income source is described below. The documentation must support the history of receipt, if applicable, and the amount, frequency, and duration of the income. In addition, evidence of current receipt of the income must be obtained in compliance with the Allowable Age of Credit Documents policy, unless specifically excluded below. See B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information.

Current receipt may be documented by various means, depending on the income type. Examples include but are not limited to

- current paystubs,
- bank statements confirming direct deposit,
- canceled checks from the payer's account to the borrower,
- court records, or
- copies of the borrower's bank statements showing the regular deposit of these funds.

#### Alimony or Child Support

The following table provides verification requirements for alimony or child support.

✓	Verification of Income From Alimony or Child Support
	<p>Document that alimony or child support will continue to be paid for at least three years after the date of the mortgage application, as verified by one of the following:</p> <ul style="list-style-type: none"> <li>• A copy of a divorce decree or separation agreement (if the divorce is not final) that indicates payment of alimony or child support and states the amount of the award and the period of time over which it will be received. <b>Note:</b> If a borrower who is separated does not have a separation agreement that specifies alimony or child support payments,</li> </ul>

	<p>the lender should not consider any proposed or voluntary payments as income.</p> <ul style="list-style-type: none"> <li>Any other type of written legal agreement or court decree describing the payment terms for the alimony or child support.</li> <li>Documentation that verifies any applicable state law that mandates alimony, child support, or separate maintenance payments, which must specify the conditions under which the payments must be made.</li> </ul>
	Check for limitations on the continuance of the payments, such as the age of the children for whom the support is being paid or the duration over which alimony is required to be paid.
	Document no less than six months of the borrower's most recent regular receipt of the full payment.
	Review the payment history to determine its suitability as stable qualifying income. To be considered stable income, full, regular, and timely payments must have been received for six months or longer. Income received for less than six months is considered unstable and may not be used to qualify the borrower for the mortgage. In addition, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for the purpose of qualifying the borrower.

### Automobile Allowance

For an automobile allowance to be considered as acceptable stable income, the borrower must have received payments for at least two years. The lender must add the full amount of the allowance to the borrower's monthly income, and the full amount of the lease or financing expenditure to the borrower's monthly debt obligations.

### Boarder Income

Income from boarders in the borrower's principal residence or second home is not considered acceptable stable income with the exception of the following:

- When a borrower with disabilities receives rental income from a live-in personal assistant, whether or not that individual is a relative of the borrower, the rental payments can be considered as acceptable stable income in an amount up to 30% of the total gross income that is used to qualify the borrower for the mortgage loan. Personal assistants typically are paid by Medicaid Waiver funds and include room and board, from which rental payments are made to the borrower.
- The HomeReady mortgage eligibility requirements include an additional exception. See Chapter B5-6, HomeReady Mortgage.

The following table provides verification requirements for income from boarders.

✓	Verification of Income from Boarders
	Obtain documentation of the boarder's history of shared residency (such as a copy of a driver's license, bills, bank statements, or W-2 forms) that shows the boarder's address as being the same as the borrower's address.
	Obtain documentation of the boarder's rental payments for the most recent 12 months.

### Capital Gains Income

Income received from capital gains is generally a one-time transaction; therefore, it should not be considered as part of the borrower's stable monthly income. However, if the borrower needs to rely on income from capital gains to qualify, the income must be verified in accordance with the following requirements.

✓	Verification of Capital Gains Income
	Document a two-year history of capital gains income by obtaining copies of the borrower's signed federal income tax returns for the most recent two years, including IRS Form 1040, Schedule D.
	<p>Develop an average income from the last two years (according to the Variable Income section of B3-3.1-01, General Income Information (08/07/2019)), and use the averaged amount as part of the borrower's qualifying income as long as the borrower provides current evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage loan payments.</p> <p><b>Note:</b> Capital losses identified on IRS Form 1040, Schedule D, do not have to be considered when calculating income or liabilities, even if the losses are recurring.</p> <p>Due to the nature of this income, current receipt of the income is not required to comply with the Allowable Age of Credit Documents policy. However, documentation of the asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information).</p>

### Disability Income – Long-Term

The following table provides verification requirements for long-term disability income. It does not apply to disability income that is received from the Social Security Administration. See the applicable section below for information on Social Security income.

✓	Verification of Long-Term Disability Income
	<p>Obtain a copy of the borrower's disability policy or benefits statement from the benefits payer (insurance company, employer, or other qualified disinterested party) to determine</p> <ul style="list-style-type: none"> <li>the borrower's current eligibility for the disability benefits,</li> <li>the amount and frequency of the disability payments, and</li> <li>if there is a contractually established termination or modification date.</li> </ul>
	<p>Generally, long-term disability will not have a defined expiration date and must be expected to continue. The requirement for re-evaluation of benefits is not considered a defined expiration date.</p> <p>If a borrower is currently receiving short-term disability payments that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the amount of the long-term benefits must be used as income to qualify the borrower. For additional information on short-term disability, see Temporary Leave Income below.</p>

### Employment Offers or Contracts

If the borrower is scheduled to begin employment under the terms of an employment offer or contract, the lender may deliver the loan in accordance with one of the options outlined below.

✓	<b>Option 1 -- Paystub Obtained Before Loan Delivery</b>
	The lender must obtain an executed copy of the borrower's offer or contract for future employment and anticipated income.
	Prior to delivering the loan, the lender must obtain a paystub from the borrower that includes sufficient information to support the income used to qualify the borrower based on the offer or contract. The paystub must be retained in the mortgage loan file.

✓	<b>Option 2 -- Paystub Not Obtained Before Loan Delivery</b>						
	<p>This option is limited to loans that meet the following criteria:</p> <ul style="list-style-type: none"> <li>• purchase transaction,</li> <li>• principal residence,</li> <li>• one-unit property,</li> <li>• the borrower is not employed by a family member or by an interested party to the transaction, and</li> <li>• the borrower is qualified using only fixed based income.</li> </ul>						
	<p>The lender must obtain and review the borrower's offer or contract for future employment. The employment offer or contract must</p> <ul style="list-style-type: none"> <li>• clearly identify the employer and the borrower, be signed by the employer, and be accepted and signed by the borrower;</li> <li>• clearly identify the terms of employment, including position, type and rate of pay, and start date; and</li> <li>• 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.</li> </ul> <p>Also note that for a union member who works in an occupation that results in a series of short-term job assignments (such as a skilled construction worker, longshoreman, or stagehand), the union may provide the executed employment offer or contract for future employment.</p>						
	<p>The borrower's start date must be no earlier than 30 days prior to the note date or no later than 90 days after the note date. Prior to delivery, the lender must obtain the following documentation depending on the borrower's employment start date:</p> <table border="1" style="width: 100%;"> <thead> <tr> <th style="text-align: left;">If the borrower's start date is...</th> <th style="text-align: left;">Documentation Required</th> </tr> </thead> <tbody> <tr> <td>The note date or no more than 30 days prior to the note date</td> <td> <ul style="list-style-type: none"> <li>• Employment offer or contract; and</li> <li>• Verbal verification of employment that confirms active employment status</li> </ul> </td> </tr> <tr> <td>No more than 90 days after the note date</td> <td>Employment offer or contract</td> </tr> </tbody> </table>	If the borrower's start date is...	Documentation Required	The note date or no more than 30 days prior to the note date	<ul style="list-style-type: none"> <li>• Employment offer or contract; and</li> <li>• Verbal verification of employment that confirms active employment status</li> </ul>	No more than 90 days after the note date	Employment offer or contract
If the borrower's start date is...	Documentation Required						
The note date or no more than 30 days prior to the note date	<ul style="list-style-type: none"> <li>• Employment offer or contract; and</li> <li>• Verbal verification of employment that confirms active employment status</li> </ul>						
No more than 90 days after the note date	Employment offer or contract						
	<p>The lender must document, in addition to the amount of reserves required by DU or for the transaction, one of the following:</p> <ul style="list-style-type: none"> <li>• Financial reserves sufficient to cover principal, interest, taxes, insurance, and association dues (PITIA) for the subject property for six months; or</li> <li>• Financial resources sufficient to cover the monthly liabilities included in the debt-to-income ratio, including the PITIA for the subject property, for the number of months between the note date and the employment start date, plus one. For calculation purposes, consider any portion of a month as a full month.</li> </ul> <p>Financial resources may include:</p> <ul style="list-style-type: none"> <li>- financial reserves, and</li> <li>- current income.</li> </ul> <p>Current income refers to net income that is currently being received by the borrower (or coborrower), may or may not be used for qualifying, and may or may not continue after the borrower starts employment under the offer or contract. For this purpose, the lender may use the amount of income the borrower is expected to receive between the note date and the employment start date. If the current income is not being used for qualifying purposes, it can be documented by the lender using income documentation, such as a paystub, but a verification of employment is not required.</p>						
	The lender must deliver the loan with Special Feature Code 707.						

### Employment-Related Assets as Qualifying Income

The following table provides the requirements for employment-related assets that may be used as qualifying income.

✓	<b>Asset Requirements</b>
	<p>Assets used for the calculation of the monthly income stream must be owned individually by the borrower, or the co-owner of the assets must be a co-borrower of the mortgage loan.</p> <p>The documentation must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information).</p>

	Assets must be liquid and available to the borrower and must be sourced as one of the following: <ul style="list-style-type: none"> <li>A non-self-employed severance package or non-self-employed lump sum retirement package (a lump sum distribution) – these funds must be documented with a distribution letter from the employer (Form 1099-R) and deposited to a verified asset account.</li> <li>For 401(k) or IRA, SEP, Keogh retirement accounts – the borrower must have unrestricted access to the funds in the accounts and can only use the accounts if distribution is not already set up or the distribution amount is not enough to qualify. The account and its asset composition must be documented with the most recent monthly, quarterly, or annual statement.</li> </ul>
	If a penalty would apply to a distribution of funds from the account made at the time of calculation, then the amount of such penalty applicable to a complete distribution from the account (after costs for the transaction) must be subtracted to determine the income stream from these assets.
	If the employment-related assets are in the form of stocks, bonds, and mutual funds, 70% of the value (remaining after costs for the transaction and consideration of any penalty) must be used to determine the income stream to account for the volatile nature of these assets.
	A borrower shall only be considered to have unrestricted access to a 401(k) or IRA, SEP, Keogh retirement account if the borrower has, as of the time of calculation, the unqualified and unlimited right to request a distribution of all funds in the account (regardless of any possible tax withholding or applicable penalty applied to such distribution).
	"Net documented assets" are equal to the sum of eligible assets minus: <ol style="list-style-type: none"> <li>the amount of the penalty that would apply if the account was completely distributed at the time of calculation;</li> <li>the amount of funds used for down payment, closing costs, and required reserves;</li> <li>30% of the remaining value of any stocks, bonds, or mutual funds assets (after the calculation in (b)).</li> </ol>
	Ineligible assets are non-employment-related assets (for example, stock options, non-vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, and divorce proceeds). Checking and savings accounts are generally not eligible as employment-related assets, unless the source of the balance in a checking or savings account was from an eligible employment-related asset (for example, a severance package or lump sum retirement distribution).
	<b>Example: Calculation of Net Documented Assets</b>
	IRA (made up of stocks and mutual funds) \$ 500,000
	Minus 10% of \$500,000 (\$500,000 x .10) (Assumes a 10% penalty applies for early distribution, which must be levied against any cash being withdrawn for closing the transaction as well as the remaining funds used to calculate the income stream.) (-) \$50,000
	Total eligible documented assets (=) \$ 450,000
	Minus funds required for closing (down payment, closing costs, reserves) (-) \$100,000
	(a) Subtotal (=) \$ 350,000
	Minus 30% of \$350,000 (\$350,000 x .30) (-) \$105,000
	<b>(b) Net Documented Assets (=) \$245,000</b>
	Monthly income calculation (\$245,000/360 (or applicable term of loan in months)) \$680.56/month See Income Calculation/Payout Stream in table below.

All of the following loan parameters must be met in order for employment-related assets to be used as qualifying income:

Loan Parameter	Requirement
Maximum LTV, CLTV, and HCLTV Ratio	70% 80% if the owner of the asset(s) being used to qualify is at least 62 years old at the time of closing. If the asset(s) is jointly owned, all owners must be a borrower on the loan and the borrower using the income to qualify must be at least 62 years old at the time of closing.
Minimum Credit Score	DU: 620 Manual: Higher of 620 or minimum credit score per the Eligibility Matrix
Loan Purpose	Purchase and limited cash-out refinance only
Occupancy	Principal residence and second home only
Number of Units	As permitted by occupancy type
Income Calculation/Payout Stream	Divide "Net Documented Assets" by the amortization term of the mortgage loan (in months).

**Note:** If the mortgage loan does not meet the above parameters, employment-related assets may still be eligible under other standard income guidelines, such as "Interest and Dividends Income," or "Retirement, Government Annuity, and Pension Income."

## Foreign Income

Foreign income is income that is earned by a borrower who is employed by a foreign corporation or a foreign government and is paid in foreign currency. Borrowers may use foreign income to qualify if the following requirements are met.

✓	Verification of Foreign Income
	Copies of his or her signed federal income tax returns for the most recent two years that include foreign income.
	The lender must satisfy the standard documentation requirements based on the source and type of income as outlined in Chapter B3-3, Income Assessment.  <b>Note:</b> All income must be translated to U.S. dollars. If the borrower is not a U.S. citizen, refer to B2-2-02, Non-U.S. Citizen Borrower Eligibility Requirements (07/28/2015), for additional information.

## Foster-Care Income

Income received from a state- or county-sponsored organization for providing temporary care for one or more children may be considered acceptable stable income if the following requirements are met.

✓	Verification of Foster-Care Income
	Verify the foster-care income with letters of verification from the organizations providing the income.
	Document that the borrower has a two-year history of providing foster-care services. If the borrower has not been receiving this type of income for two full years, the income may still be counted as stable income if <ul style="list-style-type: none"> <li>• the borrower has at least a 12-month history of providing foster-care services, and</li> <li>• the income does not represent more than 30% of the total gross income that is used to qualify for the mortgage loan.</li> </ul>

## Housing or Parsonage Allowance

A housing or parsonage allowance may be considered qualifying income if there is documentation that it has been received for the most recent 12 months and the allowance is likely to continue for the next three years. The housing allowance may be added to income but may not be used to offset the monthly housing payment.

**Note:** This requirement does not apply to military quarters' allowance. For information on military housing, refer to B3-3.1-03, Base Pay (Salary or Hourly), Bonus, and Overtime Income (05/15/2012).

## Interest and Dividends Income

The following table provides verification requirements for interest and dividends income.

✓	Verification of Income From Interest and Dividends
	Verify the borrower's ownership of the assets on which the interest or dividend income was earned. Documentation of asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information).
	Document a two-year history of the income, as verified by <ul style="list-style-type: none"> <li>• copies of the borrower's signed federal income tax returns, or</li> <li>• copies of account statements.</li> </ul>
	Develop an average of the income received for the most recent two years. Refer to the Variable Income section of B3-3.1-01, General Income Information (08/07/2019), for additional information.
	Subtract any assets used for down payment or closing costs from the borrower's total assets before calculating expected future interest or dividend income.

## Mortgage Credit Certificates

States and municipalities can issue mortgage credit certificates (MCCs) in place of, or as part of, their authority to issue mortgage revenue bonds. MCCs enable an eligible first-time home buyer to obtain a mortgage secured by his or her principal residence and to claim a federal tax credit for a specified percentage (usually 20% to 25%) of the mortgage interest payments.

When calculating the borrower's DTI ratio, treat the maximum possible MCC income as an addition to the borrower's income, rather than as a reduction to the amount of the borrower's mortgage payment. Use the following calculation when determining the available income:

$$[(\text{Mortgage Amount}) \times (\text{Note Rate}) \times (\text{MCC \%})] \div 12 = \text{Amount added to borrower's monthly income.}$$

For example, if a borrower obtains a \$100,000 mortgage that has a note rate of 7.5% and he or she is eligible for a 20% credit under the MCC program, the amount that should be added to his or her monthly income would be \$125 ( $\$100,000 \times 7.5\% \times 20\% = \$1500 \div 12 = \$125$ ).

The lender must obtain a copy of the MCC and the lender's documented calculation of the adjustment to the borrower's income and include them in the mortgage loan file.

For refinancing transactions, the lender may allow the MCC to remain in place as long as it obtains confirmation prior to loan closing from the MCC provider that the MCC remains in effect for the new mortgage loan. Copies of the MCC documents, including the reissue certification, must be maintained in the new mortgage loan file.

**Note:** Because the MCC is transaction specific, it does not have to comply with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information).

### Mortgage Differential Payments Income

An employer may subsidize an employee's mortgage payments by paying all or part of the interest differential between the employee's present and proposed mortgage payments.

When calculating the qualifying ratio, the differential payments should be added to the borrower's gross income.

The payments may not be used to directly offset the mortgage payment, even if the employer pays them to the mortgage lender rather than to the borrower.

The following table provides verification requirements for mortgage differential payment income.

✓	<b>Verification of Income From Mortgage Differential Payments</b>
	Obtain written verification from the borrower's employer confirming the subsidy and stating the amount and duration of the payments.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application. If this income is used on a purchase transaction, current receipt is not required to be documented except as verified in the employer letter. For refinance transactions where the income is continuing with the new loan, the recent receipt must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information).

### Non-Occupant Borrower Income

DU will consider a non-occupant borrower's income as qualifying income for a principal residence with certain LTV ratio limitations.

For manually underwritten loans, the income from a non-occupant borrower may be considered as acceptable qualifying income. This income can offset certain weaknesses that may be in the occupant borrower's loan application, such as limited income, financial reserves, or limited credit history. However, it may not be used to offset significant or recent instances of major derogatory credit in the occupant borrower's credit history. The occupant borrower must still reasonably demonstrate a willingness to make the mortgage payments and maintain homeownership. If the income from a non-occupant borrower is used for qualifying, the LTV ratios are limited.

See B2-2-04, Guarantors, Co-Signers, or Non-Occupant Borrowers on the Subject Transaction (09/02/2020), for information about the maximum LTV, CLTV, and HCLTV ratios that apply when non-occupant borrower income is used for qualifying purposes for both DU and manually underwritten loans.

### Notes Receivable Income

The following table provides verification requirements for notes receivable income.

✓	<b>Verification of Income From Notes Receivable</b>
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.
	Obtain a copy of the note to establish the amount and length of payment.
	Document regular receipt of income for the most recent 12 months. Payments on a note executed within the past 12 months, regardless of the duration, may not be used as stable income.

### Public Assistance Income

The following table provides verification requirements for public assistance income.

✓	<b>Verification of Public Assistance Income</b>
	Document the borrower's receipt of public assistance income with letters or exhibits from the paying agency that state the amount, frequency, and duration of the benefit payments.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.

The Housing Choice Voucher Program (more commonly known as Section 8) is also an acceptable source of qualifying income. There is no requirement for the Section 8 voucher payments to have been received for any period of time prior to the date of the mortgage application or for the payments to continue for any period of time from the date of the mortgage application.

✓	<b>Verification of Section 8 Payment Vouchers</b>
	Determine from the public agency that issues the vouchers the monthly payment amount and whether the income is nontaxable. If the income is nontaxable, the lender can develop an adjusted gross income for the borrower. See B3-3.1-01, General Income Information (08/07/2019), for additional information.

### Retirement, Government Annuity, and Pension Income

The following table provides verification requirements for retirement and pension income.

✓	<b>Verification of Retirement and Pension Income</b>
	Document regular and continued receipt of the income, as verified by <ul style="list-style-type: none"> <li>• letters from the organizations providing the income,</li> <li>• copies of retirement award letters,</li> <li>• copies of signed federal income tax returns,</li> <li>• IRS W-2 or 1099 forms, or</li> </ul>

	<ul style="list-style-type: none"> <li>• proof of current receipt.</li> </ul>
	<p>If retirement income is paid in the form of a distribution from a 401(k), IRA, or Keogh retirement account, determine whether the income is expected to continue for at least three years after the date of the mortgage application. In addition</p> <ul style="list-style-type: none"> <li>• the borrower must have unrestricted access without penalty to the accounts; and</li> <li>• if the assets are in the form of stocks, bonds, or mutual funds, 70% of the value (remaining after any applicable costs for the subject transaction) must be used to determine the number of distributions remaining to account for the volatile nature of these assets.</li> </ul> <p>Documentation of asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), for additional information).</p>

If a borrower's retirement, annuity, or pension income is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020).

### Royalty Payment Income

The following table provides verification requirements for royalty income.

✓	Verification of Income From Royalty Payments
	<p>Obtain copies of the</p> <ul style="list-style-type: none"> <li>• royalty contract, agreement, or statement confirming amount, frequency, and duration of the income; and</li> <li>• borrower's most recent signed federal income tax return, including the related IRS Form 1040, Schedule E.</li> </ul>
	<p>Confirm that the borrower has received royalty payments for at least 12 months and that the payments will continue for a minimum of three years after the date of the mortgage application.</p>

Refer to the Variable Income section of B3-3.1-01, General Income Information (08/07/2019), for additional information.

### Schedule K-1 Income

For borrowers who have less than 25% ownership of a partnership, S corporation, or limited liability company (LLC), ordinary income, net rental real estate income, and other net rental income reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 may be used in qualifying the borrower provided the lender can confirm the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

The following table provides verification of income requirements for Schedule K-1 borrowers with less than 25% ownership of a partnership, an S corporation, or an LLC.

✓	Verification of Schedule K-1 Income
	<p>If the Schedule K-1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required. The Schedule K-1 income may then be included in the borrower's cash flow.</p>
	<p>If the Schedule K-1 does not reflect a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then the lender must confirm the business has adequate liquidity to support the withdrawal of earnings. The lender may use discretion in the method used to confirm the business has adequate liquidity.</p>
	<p>If the borrower has a two-year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's cash flow.</p> <p><b>Note:</b> An exception to the two-year requirement of receiving "guaranteed payments to the partner" is if a borrower has recently acquired nominal ownership in a professional services partnership (for example, a medical practice or a law firm) after having an established employment history with the partnership. In this situation, the lender may rely on the borrower's guaranteed compensation. This must be evidenced by the borrower's partnership agreement and further supported by evidence of current year-to-date income.</p>

### Documentation Requirements

The borrower must provide the most recent two years of signed individual federal income tax returns and the most recent two years of IRS Schedule K-1.

### Social Security Income

The following table provides verification requirements for Social Security income.

✓	Verification of Social Security Income
	<p>Social Security income for retirement or long-term disability that the borrower is drawing from his or her own account/work record will not have a defined expiration date and must be expected to continue. However, if Social Security benefits are being paid as a benefit for a family member of the benefit owner, that income may be used in qualifying if the lender obtains documentation that confirms the remaining term is at least three years from the date of the mortgage application.</p>
	<p>Document regular receipt of payments, as verified by the following, depending on the type of benefit and the relationship of the beneficiary (self or other) as shown in the table below.</p>

Documentation Requirements		
Type of Social Security benefit	Borrower is drawing Social Security benefits from own account/work record <sup>1</sup>	Borrower is drawing Social Security benefits from another person's account/work record <sup>2</sup>
Retirement	<ul style="list-style-type: none"> <li>Social Security Administrator's (SSA) Award letter, or</li> <li>Proof of current receipt</li> </ul>	<ul style="list-style-type: none"> <li>SSA Award letter,</li> <li>Proof of current receipt, <b>AND</b></li> <li>Three-year continuance (e.g., verification of beneficiary's age)</li> </ul>
Disability		
Survivor Benefits	NA	
Supplement Security Income (SSI)	<ul style="list-style-type: none"> <li>SSA Award letter, and</li> <li>Proof of current receipt</li> </ul>	NA

If a borrower's Social Security income is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020).

<sup>1</sup> An SSA Award letter may be used to document the income if the borrower is receiving Social Security payments or if the borrower will begin receiving payments on or before the first payment date of the subject mortgage as confirmed by a recently issued award letter.

<sup>2</sup> Examples of how a borrower might draw Social Security benefits from another person's account/work record and use the income for qualifying:

- A borrower may be eligible for benefits from a spouse, ex-spouse, or dependent parents (the benefit is paid to the borrower on behalf of the spouse, etc.); or
- A borrower may use Social Security income received by a dependent (a minor or disabled dependent).

### Temporary Leave Income

Temporary leave from work is generally short in duration and for reasons of maternity or parental leave, short-term medical disability, or other temporary leave types that are acceptable by law or the borrower's employer. Borrowers on temporary leave may or may not be paid during their absence from work.

If a lender is made aware that a borrower will be on temporary leave at the time of closing of the mortgage loan and that borrower's income is needed to qualify for the loan, the lender must determine allowable income and confirm employment as described below.

✓	Temporary Leave -- Employment Requirements
	The borrower's employment and income history must meet standard eligibility requirements as described in Section B3-3.1, Employment and Other Sources of Income.
	The borrower must provide written confirmation of his or her intent to return to work.
	The lender must document the borrower's agreed-upon date of return by obtaining, either from the borrower or directly from the employer (or a designee of the employer when the employer is using the services of a third party to administer employee leave), documentation evidencing such date that has been produced by the employer or by a designee of the employer.  Examples of the documentation may include, but are not limited to, previous correspondence from the employer or designee that specifies the duration of leave or expected return date or a computer printout from an employer or designee's system of record. (This documentation does not have to comply with the Allowable Age of Credit Documents policy.)
	The lender must receive no evidence or information from the borrower's employer indicating that the borrower does not have the right to return to work after the leave period.
	The lender must obtain a verbal verification of employment in accordance with B3-3.1-07, Verbal Verification of Employment (10/02/2018). If the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower employed.
	The lender must verify the borrower's income in accordance with Section B3-3.1, Employment and Other Sources of Income. The lender must obtain <ul style="list-style-type: none"> <li>the amount and duration of the borrower's "temporary leave income," which may require multiple documents or sources depending on the type and duration of the leave period; and</li> <li>the amount of the "regular employment income" the borrower received prior to the temporary leave. Regular employment income includes, but is not limited to, the income the borrower receives from employment on a regular basis that is eligible for qualifying purposes (for example, base pay, commissions, and bonus).</li> </ul> <p><b>Note:</b> Income verification may be provided by the borrower, by the borrower's employer, or by a third-party employment verification vendor.</p>

### Requirements for Calculating Income Used for Qualifying

If the borrower **will** return to work as of the first mortgage payment date, the lender can consider the borrower's regular employment income in qualifying.

If the borrower will **not** return to work as of the first mortgage payment date, the lender must use the lesser of the borrower's temporary leave income (if any) or regular employment income. If the borrower's temporary leave income is less than his or her regular employment income, the lender may supplement the temporary leave income with available liquid financial reserves (see B3-4.1-01, Minimum Reserve Requirements (10/07/2020)). Following are instructions on how to calculate the "supplemental income":

**Supplemental income amount = available liquid reserves divided by the number of months of supplemental income**

- Available liquid reserves:* subtract any funds needed to complete the transaction (down payment, closing costs, other required debt

payoff, escrows, and minimum required reserves) from the total verified liquid asset amount.

- **Number of months of supplemental income:** the number of months from the first mortgage payment date to the date the borrower will begin receiving his or her regular employment income, rounded up to the next whole number.

After determining the supplemental income, the lender must calculate the total qualifying income.

**Total qualifying income = supplemental income plus the temporary leave income**

The total qualifying income that results may not exceed the borrower's regular employment income.

**Example**

Regular income amount: \$6,000 per month

Temporary leave income: \$2,000 per month

Total verified liquid assets: \$30,000

Funds needed to complete the transaction: \$18,000

Available liquid reserves: \$12,000

First payment date: July 1

Date borrower will begin receiving regular employment income: November 1

Supplemental income:  $\$12,000/4 = \$3,000$

Total qualifying income:  $\$3,000 + \$2,000 = \$5,000$

For loan casefiles underwritten with DU, refer to B3-3.5-01, Income and Employment Documentation for DU (08/07/2019), for data entry guidance.

**Note:** These requirements apply if the lender becomes aware through the employment and income verification process that the borrower is on temporary leave. If a borrower is not currently on temporary leave, the lender must not ask if he or she intends to take leave in the future.

**Tip Income**

The following table provides verification requirements for tip income.

✓	Verification of Tip Income
	Obtain the following documents: <ul style="list-style-type: none"> <li>• a completed <i>Request for Verification of Employment</i> (Form 1005 or Form 1005(S)), or</li> <li>• the borrower's recent paystub, and</li> <li>• IRS W-2 forms covering the most recent two-year period or the most recent two years tax returns with IRS Form 4137, <i>Social Security and Medicare Tax on Unreported Tip Income</i>, to verify tips not reported by the employer.</li> </ul> See B3-3.1-02, <i>Standards for Employment Documentation</i> (10/24/2016), for additional information.
	Tip income may be used to qualify the borrower if the lender verifies that the borrower has received it for the last two years.
	The lender must determine the amount of tip income that may be considered in qualifying the borrower. Refer to the Variable Income section of B3-3.1-01, <i>General Income Information</i> (08/07/2019), for additional information.

Tip income must be entered in DU in the Other Monthly Income section of the loan application as "Other Types of Income" and verified according to these requirements.

**Trust Income**

The following table provides verification requirements for trust income.

✓	Verification of Trust Income
	Confirm the trust income by obtaining a copy of the trust agreement or the trustee's statement confirming the amount, frequency, and duration of payments.
	Verify that the trust income will continue for at least three years from the date of the mortgage application. Unless this income is received monthly, documentation of current receipt of the income is not required to comply with the Allowable Age of Credit Documents policy.

**Unemployment Benefits Income**

The following table provides verification requirements for income from unemployment benefits, such as those received by seasonal workers.

✓	Verification of Income From Unemployment Benefits
	Document that the borrower has received the payments consistently for at least two years by obtaining copies of signed federal income tax returns.
	Unemployment compensation cannot be used to qualify the borrower unless it is clearly associated with seasonal employment that is reported on the borrower's signed federal income tax returns. Verify that the seasonal income is likely to continue. See B3-3.1-05, <i>Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income</i> (08/07/2019), for additional information about verifying seasonal income.

**Note:** Unemployment compensation may be used in qualifying a borrower for a high LTV refinance loan whether it is seasonal or non-seasonal.

## VA Benefits Income

The following table provides verification requirements for income from VA benefits.

**Note:** Education benefits are not acceptable income because they are offset by education expenses.

✓	Verification of VA Benefits Income
	Document the borrower's receipt of VA benefits with a letter or distribution form from the VA.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application. (Verification is not required for VA retirement or long-term disability benefits.)

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-08	October 02, 2018
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2016-04	May 31, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2014-06	May 27, 2014
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
Announcement 09-19	June 8, 2009

## B3-3.1-09, Other Sources of Income (12/16/2020)

### Introduction

This topic provides information on documenting and qualifying a borrower's income from sources other than wages and salaries, including:

- Documentation Requirements for Current Receipt of Income
- Alimony, Child Support, or Separate Maintenance
- Automobile Allowance
- Boarder Income
- Capital Gains Income
- Disability Income — Long-Term
- Employment Offers or Contracts
- Employment-Related Assets as Qualifying Income
- Foreign Income
- Foster-Care Income
- Housing or Parsonage Allowance
- Interest and Dividends Income
- Mortgage Credit Certificates

- Mortgage Differential Payments Income
- Non-Occupant Borrower Income
- Notes Receivable Income
- Public Assistance Income
- Retirement, Government Annuity, and Pension Income
- Royalty Payment Income
- Schedule K-1 Income
- Social Security Income
- Temporary Leave Income
- Tip Income
- Trust Income
- Unemployment Benefits Income
- VA Benefits Income

### Documentation Requirements for Current Receipt of Income

The documentation required for each income source is described below. The documentation must support the history of receipt, if applicable, and the amount, frequency, and duration of the income. In addition, evidence of current receipt of the income must be obtained in compliance with the Allowable Age of Credit Documents policy, unless specifically excluded below. See B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), for additional information.

Current receipt may be documented by various means, depending on the income type. Examples include but are not limited to

- current paystubs,
- bank statements confirming direct deposit,
- canceled checks from the payer's account to the borrower,
- court records, or
- copies of the borrower's bank statements showing the regular deposit of these funds.

### Alimony, Child Support, or Separate Maintenance

The following table provides verification requirements for alimony, child support, or separate maintenance.

✓	<b>Verification of Income From Alimony, Child Support, or Separate Maintenance</b>
	Document that alimony, child support, or separate maintenance will continue to be paid for at least three years after the date of the mortgage application, as verified by one of the following: <ul style="list-style-type: none"> <li>• A copy of a divorce decree or separation agreement (if the divorce is not final) that indicates the monthly payment and states the amount of the award and the period of time over which it will be received. <b>Note:</b> If a borrower who is separated does not have a separation agreement that specifies alimony or child support payments, the lender should not consider any proposed or voluntary payments as income.</li> <li>• Any other type of written legal agreement or court decree describing the payment terms.</li> <li>• Documentation that verifies any applicable state law that mandates alimony, child support, or separate maintenance payments, which must specify the conditions under which the payments must be made.</li> </ul>
	Check for limitations on the continuance of the payments, such as the age of the children for whom the support is being paid or the duration over which alimony is required to be paid.
	Document no less than six months of the borrower's most recent regular receipt of the full payment.
	Review the payment history to determine its suitability as stable qualifying income. To be considered stable income, full, regular, and timely payments must have been received for six months or longer. Income received for less than six months is considered unstable and may not be used to qualify the borrower for the mortgage. In addition, if full or partial payments are made on an inconsistent or sporadic basis, the income is not acceptable for the purpose of qualifying the borrower.

**Note:** The lender may include alimony, child support, or separate maintenance as income only if the borrower discloses it on the Form 1003 and requests that it be considered in qualifying for the loan.

### Automobile Allowance

For an automobile allowance to be considered as acceptable stable income, the borrower must have received payments for at least two years. The lender must add the full amount of the allowance to the borrower's monthly income, and the full amount of the lease or financing expenditure to the borrower's monthly debt obligations.

### Boarder Income

Income from boarders in the borrower's principal residence or second home is not considered acceptable stable income with the exception of the following:

- When a borrower with disabilities receives rental income from a live-in personal assistant, whether or not that individual is a relative of the borrower, the rental payments can be considered as acceptable stable income in an amount up to 30% of the total gross income that is used to qualify the borrower for the mortgage loan. Personal assistants typically are paid by Medicaid Waiver funds and include room and board, from which rental payments are made to the borrower.
- The HomeReady mortgage eligibility requirements include an additional exception. See Chapter B5-6, HomeReady Mortgage.

The following table provides verification requirements for income from boarders.

✓	<b>Verification of Income from Boarders</b>

	Obtain documentation of the boarder's history of shared residency (such as a copy of a driver's license, bills, bank statements, or W-2 forms) that shows the boarder's address as being the same as the borrower's address.
	Obtain documentation of the boarder's rental payments for the most recent 12 months.

### Capital Gains Income

Income received from capital gains is generally a one-time transaction; therefore, it should not be considered as part of the borrower's stable monthly income. However, if the borrower needs to rely on income from capital gains to qualify, the income must be verified in accordance with the following requirements.

✓	Verification of Capital Gains Income
	Document a two-year history of capital gains income by obtaining copies of the borrower's signed federal income tax returns for the most recent two years, including IRS Form 1040, Schedule D.
	<p>Develop an average income from the last two years (according to the Variable Income section of B3-3.1-01, General Income Information (12/16/2020)), and use the averaged amount as part of the borrower's qualifying income as long as the borrower provides current evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage loan payments.</p> <p><b>Note:</b> Capital losses identified on IRS Form 1040, Schedule D, do not have to be considered when calculating income or liabilities, even if the losses are recurring.</p> <p>Due to the nature of this income, current receipt of the income is not required to comply with the Allowable Age of Credit Documents policy. However, documentation of the asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), for additional information).</p>

### Disability Income – Long-Term

The following table provides verification requirements for long-term disability income. It does not apply to disability income that is received from the Social Security Administration. See the applicable section below for information on Social Security income.

✓	Verification of Long-Term Disability Income
	<p>Obtain a copy of the borrower's disability policy or benefits statement from the benefits payer (insurance company, employer, or other qualified disinterested party) to determine</p> <ul style="list-style-type: none"> <li>• the borrower's current eligibility for the disability benefits,</li> <li>• the amount and frequency of the disability payments, and</li> <li>• if there is a contractually established termination or modification date.</li> </ul>
	<p>Generally, long-term disability will not have a defined expiration date and must be expected to continue. The requirement for re-evaluation of benefits is not considered a defined expiration date.</p> <p>If a borrower is currently receiving short-term disability payments that will decrease to a lesser amount within the next three years because they are being converted to long-term benefits, the amount of the long-term benefits must be used as income to qualify the borrower. For additional information on short-term disability, see Temporary Leave Income below.</p>

### Employment Offers or Contracts

If the borrower is scheduled to begin employment under the terms of an employment offer or contract, the lender may deliver the loan in accordance with one of the options outlined below.

✓	Option 1 -- Paystub Obtained Before Loan Delivery
	The lender must obtain an executed copy of the borrower's offer or contract for future employment and anticipated income.
	Prior to delivering the loan, the lender must obtain a paystub from the borrower that includes sufficient information to support the income used to qualify the borrower based on the offer or contract. The paystub must be retained in the mortgage loan file.

✓	Option 2 -- Paystub Not Obtained Before Loan Delivery
	<p>This option is limited to loans that meet the following criteria:</p> <ul style="list-style-type: none"> <li>• purchase transaction,</li> <li>• principal residence,</li> <li>• one-unit property,</li> <li>• the borrower is not employed by a family member or by an interested party to the transaction, and</li> <li>• the borrower is qualified using only fixed based income.</li> </ul>
	<p>The lender must obtain and review the borrower's offer or contract for future employment. The employment offer or contract must</p> <ul style="list-style-type: none"> <li>• clearly identify the employer and the borrower, be signed by the employer, and be accepted and signed by the borrower;</li> <li>• clearly identify the terms of employment, including position, type and rate of pay, and start date; and</li> <li>• 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.</li> </ul> <p>Also note that for a union member who works in an occupation that results in a series of short-term job assignments</p>

	(such as a skilled construction worker, longshoreman, or stagehand), the union may provide the executed employment offer or contract for future employment.	
	The borrower's start date must be no earlier than 30 days prior to the note date or no later than 90 days after the note date. Prior to delivery, the lender must obtain the following documentation depending on the borrower's employment start date:	
	<b>If the borrower's start date is...</b>	<b>Documentation Required</b>
	The note date or no more than 30 days prior to the note date	<ul style="list-style-type: none"> <li>• Employment offer or contract; and</li> <li>• Verbal verification of employment that confirms active employment status</li> </ul>
	No more than 90 days after the note date	Employment offer or contract
	<p>The lender must document, in addition to the amount of reserves required by DU or for the transaction, one of the following:</p> <ul style="list-style-type: none"> <li>• Financial reserves sufficient to cover principal, interest, taxes, insurance, and association dues (PITIA) for the subject property for six months; or</li> <li>• Financial resources sufficient to cover the monthly liabilities included in the debt-to-income ratio, including the PITIA for the subject property, for the number of months between the note date and the employment start date, plus one. For calculation purposes, consider any portion of a month as a full month.</li> </ul> <p>Financial resources may include:</p> <ul style="list-style-type: none"> <li>- financial reserves, and</li> <li>- current income.</li> </ul> <p>Current income refers to net income that is currently being received by the borrower (or coborrower), may or may not be used for qualifying, and may or may not continue after the borrower starts employment under the offer or contract. For this purpose, the lender may use the amount of income the borrower is expected to receive between the note date and the employment start date. If the current income is not being used for qualifying purposes, it can be documented by the lender using income documentation, such as a paystub, but a verification of employment is not required.</p>	
	The lender must deliver the loan with Special Feature Code 707.	

**Note:** DU will issue a verification message related to employment offers and contracts if the borrower's current employment start date is blank or after the date the loan casefile was created.

#### Employment-Related Assets as Qualifying Income

The following table provides the requirements for employment-related assets that may be used as qualifying income.

✓	Asset Requirements
	Assets used for the calculation of the monthly income stream must be owned individually by the borrower, or the co-owner of the assets must be a co-borrower of the mortgage loan. The documentation must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), for additional information).
	Assets must be liquid and available to the borrower and must be sourced as one of the following: <ul style="list-style-type: none"> <li>• A non-self-employed severance package or non-self-employed lump sum retirement package (a lump sum distribution) — these funds must be documented with a distribution letter from the employer (Form 1099-R) and deposited to a verified asset account.</li> <li>• For 401(k) or IRA, SEP, Keogh retirement accounts – the borrower must have unrestricted access to the funds in the accounts and can only use the accounts if distribution is not already set up or the distribution amount is not enough to qualify. The account and its asset composition must be documented with the most recent monthly, quarterly, or annual statement.</li> </ul>
	If a penalty would apply to a distribution of funds from the account made at the time of calculation, then the amount of such penalty applicable to a complete distribution from the account (after costs for the transaction) must be subtracted to determine the income stream from these assets.
	A borrower must only be considered to have unrestricted access to a 401(k) or IRA, SEP, Keogh retirement account if the borrower has, as of the time of calculation, the unqualified and unlimited right to request a distribution of all funds in the account (regardless of any possible tax withholding or applicable penalty applied to such distribution).
	"Net documented assets" are equal to the sum of eligible assets minus: <ol style="list-style-type: none"> <li>(a) the amount of the penalty that would apply if the account was completely distributed at the time of calculation; and</li> <li>(b) the amount of funds used for down payment, closing costs, and required reserves.</li> </ol>
	Ineligible assets are non-employment-related assets (for example, stock options, non-vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, and divorce proceeds). Checking and savings accounts are generally not eligible as employment-related assets, unless the source of the balance in a checking or savings account was from an eligible employment-related asset (for example, a severance package or lump sum retirement distribution).
	IRA (made up of stocks and mutual funds) <span style="float: right;">\$500,000</span>
	Minus 10% of \$500,000 (\$500,000 x .10) (Assumes a 10% penalty applies for early distribution, which must be levied against any cash being withdrawn for <span style="float: right;">(-) \$50,000</span>

	closing the transaction as well as the remaining funds used to calculate the income stream.)	
	Total eligible documented assets	(=) \$450,000
	Minus funds required for closing (down payment, closing costs, reserves)	(-) \$100,000
	<b>Net Documented Assets</b>	<b>(=) \$350,000</b>
	Monthly income calculation (\$350,000/360 (or applicable term of loan in months)) See Income Calculation/Payout Stream in table below.	\$972.22/month

All of the following loan parameters must be met in order for employment-related assets to be used as qualifying income:

Loan Parameter	Requirement
Maximum LTV, CLTV, and HCLTV Ratio	70% 80% if the owner of the asset(s) being used to qualify is at least 62 years old at the time of closing. If the asset(s) is jointly owned, all owners must be a borrower on the loan and the borrower using the income to qualify must be at least 62 years old at the time of closing.
Minimum Credit Score	DU: 620 Manual: Higher of 620 or minimum credit score per the Eligibility Matrix
Loan Purpose	Purchase and limited cash-out refinance only
Occupancy	Principal residence and second home only
Number of Units	As permitted by occupancy type
Income Calculation/Payout Stream	Divide "Net Documented Assets" by the amortization term of the mortgage loan (in months).

**Note:** If the mortgage loan does not meet the above parameters, employment-related assets may still be eligible under other standard income guidelines, such as "Interest and Dividends Income," or "Retirement, Government Annuity, and Pension Income."

#### Foreign Income

Foreign income is income that is earned by a borrower who is employed by a foreign corporation or a foreign government and is paid in foreign currency. Borrowers may use foreign income to qualify if the following requirements are met.

✓	Verification of Foreign Income
	Copies of his or her signed federal income tax returns for the most recent two years that include foreign income.
	The lender must satisfy the standard documentation requirements based on the source and type of income as outlined in Chapter B3-3, Income Assessment. <b>Note:</b> All income must be translated to U.S. dollars. If the borrower is not a U.S. citizen, refer to B2-2-02, Non-U.S. Citizen Borrower Eligibility Requirements (07/28/2015), for additional information.

#### Foster-Care Income

Income received from a state- or county-sponsored organization for providing temporary care for one or more children may be considered acceptable stable income if the following requirements are met.

✓	Verification of Foster-Care Income
	Verify the foster-care income with letters of verification from the organizations providing the income.
	Document that the borrower has a two-year history of providing foster-care services. If the borrower has not been receiving this type of income for two full years, the income may still be counted as stable income if <ul style="list-style-type: none"> <li>the borrower has at least a 12-month history of providing foster-care services, and</li> <li>the income does not represent more than 30% of the total gross income that is used to qualify for the mortgage loan.</li> </ul>

#### Housing or Parsonage Allowance

A housing or parsonage allowance may be considered qualifying income if there is documentation that it has been received for the most recent 12 months and the allowance is likely to continue for the next three years. The housing allowance may be added to income but may not be used to offset the monthly housing payment.

**Note:** This requirement does not apply to military quarters' allowance. For information on military housing, refer to B3-3.1-03, Base Pay (Salary or Hourly), Bonus, and Overtime Income (05/15/2012).

#### Interest and Dividends Income

The following table provides verification requirements for interest and dividends income.

✓	<b>Verification of Income From Interest and Dividends</b>
	Verify the borrower's ownership of the assets on which the interest or dividend income was earned. Documentation of asset ownership must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), for additional information).
	Document a two-year history of the income, as verified by <ul style="list-style-type: none"> <li>• copies of the borrower's signed federal income tax returns, or</li> <li>• copies of account statements.</li> </ul>
	Develop an average of the income received for the most recent two years. Refer to the Variable Income section of B3-3.1-01, General Income Information (12/16/2020), for additional information.
	Subtract any assets used for down payment or closing costs from the borrower's total assets before calculating expected future interest or dividend income.

### Mortgage Credit Certificates

States and municipalities can issue mortgage credit certificates (MCCs) in place of, or as part of, their authority to issue mortgage revenue bonds. MCCs enable an eligible first-time home buyer to obtain a mortgage secured by his or her principal residence and to claim a federal tax credit for a specified percentage (usually 20% to 25%) of the mortgage interest payments.

When calculating the borrower's DTI ratio, treat the maximum possible MCC income as an addition to the borrower's income, rather than as a reduction to the amount of the borrower's mortgage payment. Use the following calculation when determining the available income:

$$[(\text{Mortgage Amount}) \times (\text{Note Rate}) \times (\text{MCC \%})] \div 12 = \text{Amount added to borrower's monthly income.}$$

For example, if a borrower obtains a \$100,000 mortgage that has a note rate of 7.5% and he or she is eligible for a 20% credit under the MCC program, the amount that should be added to his or her monthly income would be \$125 ( $\$100,000 \times 7.5\% \times 20\% = \$1500 \div 12 = \$125$ ).

The lender must obtain a copy of the MCC and the lender's documented calculation of the adjustment to the borrower's income and include them in the mortgage loan file.

For refinance transactions, the lender may allow the MCC to remain in place as long as it obtains confirmation prior to loan closing from the MCC provider that the MCC remains in effect for the new mortgage loan. Copies of the MCC documents, including the reissue certification, must be maintained in the new mortgage loan file.

**Note:** Because the MCC is transaction specific, it does not have to comply with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), for additional information).

### Mortgage Differential Payments Income

An employer may subsidize an employee's mortgage payments by paying all or part of the interest differential between the employee's present and proposed mortgage payments.

When calculating the qualifying ratio, the differential payments should be added to the borrower's gross income.

The payments may not be used to directly offset the mortgage payment, even if the employer pays them to the mortgage lender rather than to the borrower.

The following table provides verification requirements for mortgage differential payment income.

✓	<b>Verification of Income From Mortgage Differential Payments</b>
	Obtain written verification from the borrower's employer confirming the subsidy and stating the amount and duration of the payments.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application. If this income is used on a purchase transaction, current receipt is not required to be documented except as verified in the employer letter. For refinance transactions where the income is continuing with the new loan, the recent receipt must be in compliance with the Allowable Age of Credit Documents policy (see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), for additional information).

### Non-Occupant Borrower Income

DU will consider a non-occupant borrower's income as qualifying income for a principal residence with certain LTV ratio limitations.

For manually underwritten loans, the income from a non-occupant borrower may be considered as acceptable qualifying income. This income can offset certain weaknesses that may be in the occupant borrower's loan application, such as limited income, financial reserves, or limited credit history. However, it may not be used to offset significant or recent instances of major derogatory credit in the occupant borrower's credit history. The occupant borrower must still reasonably demonstrate a willingness to make the mortgage payments and maintain homeownership. If the income from a non-occupant borrower is used for qualifying, the LTV ratios are limited.

See B2-2-04, Guarantors, Co-Signers, or Non-Occupant Borrowers on the Subject Transaction (09/02/2020), for information about the maximum LTV, CLTV, and HCLTV ratios that apply when non-occupant borrower income is used for qualifying purposes for both DU and manually underwritten loans.

### Notes Receivable Income

The following table provides verification requirements for notes receivable income.

✓	<b>Verification of Income From Notes Receivable</b>
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.

	Obtain a copy of the note to establish the amount and length of payment.
	Document regular receipt of income for the most recent 12 months. Payments on a note executed within the past 12 months, regardless of the duration, may not be used as stable income.

### Public Assistance Income

The following table provides verification requirements for public assistance income.

✓	Verification of Public Assistance Income
	Document the borrower's receipt of public assistance income with letters or exhibits from the paying agency that state the amount, frequency, and duration of the benefit payments.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application.

The Housing Choice Voucher Program (more commonly known as Section 8) is also an acceptable source of qualifying income. There is no requirement for the Section 8 voucher payments to have been received for any period of time prior to the date of the mortgage application or for the payments to continue for any period of time from the date of the mortgage application.

✓	Verification of Section 8 Payment Vouchers
	Determine from the public agency that issues the vouchers the monthly payment amount and whether the income is nontaxable. If the income is nontaxable, the lender can develop an adjusted gross income for the borrower. See B3-3.1-01, General Income Information (12/16/2020), for additional information.

### Retirement, Government Annuity, and Pension Income

The following table provides verification requirements for retirement, government annuity, and pension income.

✓	Verification of Retirement, Government Annuity, and Pension Income
	Document current receipt of the income, as verified by <ul style="list-style-type: none"> <li>• a statement from the organization providing the income,</li> <li>• a copy of retirement award letter or benefit statement,</li> <li>• a copy of financial or bank account statement,</li> <li>• a copy of signed federal income tax return,</li> <li>• an IRS W-2 form, or</li> <li>• an IRS 1099 form.</li> </ul>
	If income from a government annuity or a pension account will begin on or before the first payment date, document the income with a benefit statement from the organization providing the income. The statement must specify the income type, amount and frequency of the payment, and include confirmation of the initial start date.
	If retirement income is paid in the form of a distribution from a 401(k), IRA, or Keogh retirement account, determine whether the income is expected to continue for at least three years after the date of the mortgage application. Eligible retirement account balances (from a 401(k), IRA, or Keogh) may be combined for the purpose of determining whether the three-year continuance requirement is met.  <b>Note:</b> The borrower must have unrestricted access to the accounts without penalty.

If a borrower's retirement, annuity, or pension income is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020).

### Royalty Payment Income

The following table provides verification requirements for royalty income.

✓	Verification of Income From Royalty Payments
	Obtain copies of the <ul style="list-style-type: none"> <li>• royalty contract, agreement, or statement confirming amount, frequency, and duration of the income; and</li> <li>• borrower's most recent signed federal income tax return, including the related IRS Form 1040, Schedule E.</li> </ul>
	Confirm that the borrower has received royalty payments for at least 12 months and that the payments will continue for a minimum of three years after the date of the mortgage application.

Refer to the Variable Income section of B3-3.1-01, General Income Information (12/16/2020), for additional information.

### Schedule K-1 Income

For borrowers who have less than 25% ownership of a partnership, S corporation, or limited liability company (LLC), ordinary income, net rental real estate income, and other net rental income reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 may be used in qualifying the borrower provided the lender can confirm the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

The following table provides verification of income requirements for Schedule K-1 borrowers with less than 25% ownership of a partnership, an S corporation, or an LLC.

✓	<b>Verification of Schedule K-1 Income</b>
	If the Schedule K-1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required. The Schedule K-1 income may then be included in the borrower's cash flow.
	If the Schedule K-1 does not reflect a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then the lender must confirm the business has adequate liquidity to support the withdrawal of earnings. The lender may use discretion in the method used to confirm the business has adequate liquidity.
	<p>If the borrower has a two-year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's cash flow.</p> <p><b>Note:</b> An exception to the two-year requirement of receiving "guaranteed payments to the partner" is if a borrower has recently acquired nominal ownership in a professional services partnership (for example, a medical practice or a law firm) after having an established employment history with the partnership. In this situation, the lender may rely on the borrower's guaranteed compensation. This must be evidenced by the borrower's partnership agreement and further supported by evidence of current year-to-date income.</p>

#### Documentation Requirements

The borrower must provide the most recent two years of signed individual federal income tax returns and the most recent two years of IRS Schedule K-1.

#### Social Security Income

The following table provides verification requirements for Social Security income.

✓	<b>Verification of Social Security Income</b>
	Social Security income for retirement or long-term disability that the borrower is drawing from his or her own account/work record will not have a defined expiration date and must be expected to continue. However, if Social Security benefits are being paid as a benefit for a family member of the benefit owner, that income may be used in qualifying if the lender obtains documentation that confirms the remaining term is at least three years from the date of the mortgage application.
	Document regular receipt of payments, as verified by the following, depending on the type of benefit and the relationship of the beneficiary (self or other) as shown in the table below.

<b>Documentation Requirements</b>		
<b>Type of Social Security benefit</b>	<b>Borrower is drawing Social Security benefits from own account/work record <sup>1</sup></b>	<b>Borrower is drawing Social Security benefits from another person's account/work record <sup>2</sup></b>
Retirement	<ul style="list-style-type: none"> <li>• Social Security Administrator's (SSA) Award letter, or</li> <li>• Proof of current receipt</li> </ul>	<ul style="list-style-type: none"> <li>• SSA Award letter,</li> <li>• Proof of current receipt, <b>AND</b></li> <li>• Three-year continuance (e.g., verification of beneficiary's age)</li> </ul>
Disability		
Survivor Benefits	NA	
Supplement Security Income (SSI)	<ul style="list-style-type: none"> <li>• SSA Award letter, and</li> <li>• Proof of current receipt</li> </ul>	NA

If a borrower's Social Security income is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020).

<sup>1</sup> An SSA Award letter may be used to document the income if the borrower is receiving Social Security payments or if the borrower will begin receiving payments on or before the first payment date of the subject mortgage as confirmed by a recently issued award letter.

<sup>2</sup> Examples of how a borrower might draw Social Security benefits from another person's account/work record and use the income for qualifying:

- A borrower may be eligible for benefits from a spouse, ex-spouse, or dependent parents (the benefit is paid to the borrower on behalf of the spouse, etc.); or
- A borrower may use Social Security income received by a dependent (a minor or disabled dependent).

#### Temporary Leave Income

Temporary leave from work is generally short in duration and for reasons of maternity or parental leave, short-term medical disability, or other temporary leave types that are acceptable by law or the borrower's employer. Borrowers on temporary leave may or may not be paid during their absence from work.

If a lender is made aware that a borrower will be on temporary leave at the time of closing of the mortgage loan and that borrower's income is needed to qualify for the loan, the lender must determine allowable income and confirm employment as described below.

✓	<b>Temporary Leave -- Employment Requirements</b>
	The borrower's employment and income history must meet standard eligibility requirements as described in Section B3-3.1,

	Employment and Other Sources of Income.
	The borrower must provide written confirmation of his or her intent to return to work.
	The lender must document the borrower's agreed-upon date of return by obtaining, either from the borrower or directly from the employer (or a designee of the employer when the employer is using the services of a third party to administer employee leave), documentation evidencing such date that has been produced by the employer or by a designee of the employer.  Examples of the documentation may include, but are not limited to, previous correspondence from the employer or designee that specifies the duration of leave or expected return date or a computer printout from an employer or designee's system of record. (This documentation does not have to comply with the Allowable Age of Credit Documents policy.)
	The lender must receive no evidence or information from the borrower's employer indicating that the borrower does not have the right to return to work after the leave period.
	The lender must obtain a verbal verification of employment in accordance with B3-3.1-07, Verbal Verification of Employment (10/02/2018). If the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower employed.
	The lender must verify the borrower's income in accordance with Section B3-3.1, Employment and Other Sources of Income. The lender must obtain <ul style="list-style-type: none"> <li>the amount and duration of the borrower's "temporary leave income," which may require multiple documents or sources depending on the type and duration of the leave period; and</li> <li>the amount of the "regular employment income" the borrower received prior to the temporary leave. Regular employment income includes, but is not limited to, the income the borrower receives from employment on a regular basis that is eligible for qualifying purposes (for example, base pay, commissions, and bonus).</li> </ul> <p><b>Note:</b> Income verification may be provided by the borrower, by the borrower's employer, or by a third-party employment verification vendor.</p>

### Requirements for Calculating Income Used for Qualifying

If the borrower **will** return to work as of the first mortgage payment date, the lender can consider the borrower's regular employment income in qualifying.

If the borrower **will not** return to work as of the first mortgage payment date, the lender must use the lesser of the borrower's temporary leave income (if any) or regular employment income. If the borrower's temporary leave income is less than his or her regular employment income, the lender may supplement the temporary leave income with available liquid financial reserves (see B3-4.1-01, Minimum Reserve Requirements (10/07/2020)). Following are instructions on how to calculate the "supplemental income":

#### Supplemental income amount = available liquid reserves divided by the number of months of supplemental income

- Available liquid reserves:** subtract any funds needed to complete the transaction (down payment, closing costs, other required debt payoff, escrows, and minimum required reserves) from the total verified liquid asset amount.
- Number of months of supplemental income:** the number of months from the first mortgage payment date to the date the borrower will begin receiving his or her regular employment income, rounded up to the next whole number.

After determining the supplemental income, the lender must calculate the total qualifying income.

#### Total qualifying income = supplemental income plus the temporary leave income

The total qualifying income that results may not exceed the borrower's regular employment income.

#### Example

Regular income amount: \$6,000 per month

Temporary leave income: \$2,000 per month

Total verified liquid assets: \$30,000

Funds needed to complete the transaction: \$18,000

Available liquid reserves: \$12,000

First payment date: July 1

Date borrower will begin receiving regular employment income: November 1

Supplemental income:  $\$12,000/4 = \$3,000$

Total qualifying income:  $\$3,000 + \$2,000 = \$5,000$

For loan casefiles underwritten with DU, refer to B3-3.5-01, Income and Employment Documentation for DU (12/16/2020), for data entry guidance.

**Note:** These requirements apply if the lender becomes aware through the employment and income verification process that the borrower is on temporary leave. If a borrower is not currently on temporary leave, the lender must not ask if he or she intends to take leave in the future.

### Tip Income

The following table provides verification requirements for tip income.

✓	Verification of Tip Income
	Obtain the following documents: <ul style="list-style-type: none"> <li>a completed <i>Request for Verification of Employment</i> (Form 1005 or Form 1005(S)), or</li> </ul>

	<ul style="list-style-type: none"> <li>the borrower's recent paystub, and</li> <li>IRS W-2 forms covering the most recent two-year period or the most recent two years tax returns with IRS Form 4137, Social Security and Medicare Tax on Unreported Tip Income, to verify tips not reported by the employer.</li> </ul> <p>See B3-3.1-02, Standards for Employment Documentation (12/16/2020), for additional information.</p>
	Tip income may be used to qualify the borrower if the lender verifies that the borrower has received it for the last two years.
	The lender must determine the amount of tip income that may be considered in qualifying the borrower. Refer to the Variable Income section of B3-3.1-01, General Income Information (12/16/2020), for additional information.

### Trust Income

The following table provides verification requirements for trust income.

✓	Verification of Trust Income
	Confirm the trust income by obtaining a copy of the trust agreement or the trustee's statement confirming the amount, frequency, and duration of payments.
	Verify that the trust income will continue for at least three years from the date of the mortgage application. Unless this income is received monthly, documentation of current receipt of the income is not required to comply with the Allowable Age of Credit Documents policy.

### Unemployment Benefits Income

The following table provides verification requirements for income from unemployment benefits, such as those received by seasonal workers.

✓	Verification of Income from Unemployment Benefits
	Document that the borrower has received the payments consistently for at least two years by obtaining copies of signed federal income tax returns.
	Unemployment compensation cannot be used to qualify the borrower unless it is clearly associated with seasonal employment that is reported on the borrower's signed federal income tax returns. Verify that the seasonal income is likely to continue. See B3-3.1-05, Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (08/07/2019), for additional information about verifying seasonal income.

**Note:** Unemployment compensation may be used in qualifying a borrower for a high LTV refinance loan whether it is seasonal or non-seasonal.

### VA Benefits Income

The following table provides verification requirements for income from VA benefits.

**Note:** Education benefits are not acceptable income because they are offset by education expenses.

✓	Verification of VA Benefits Income
	Document the borrower's receipt of VA benefits with a letter or distribution form from the VA.
	Verify that the income can be expected to continue for a minimum of three years from the date of the mortgage application. (Verification is not required for VA retirement or long-term disability benefits.)

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-08	October 02, 2018
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2016-04	May 31, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2015-01	January 27, 2015

Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2014-06	May 27, 2014
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
Announcement 09-19	June 8, 2009

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### **B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower (10/24/2016)**

#### **Introduction**

This topic contains general information on underwriting factors and documentation for a self-employed borrower, including:®

- Overview
- Factors to Consider for a Self-Employed Borrower
- Length of Self-Employment
- Verification of Income
- Analysis of Borrower's Personal Income
- Analysis of Borrower's Business Income
- Use of Business Assets
- Income Verification for Self-Employed Co-Borrowers
- Verbal Verification of Employment

#### **Overview**

When determining the appropriate qualifying income for a self-employed borrower, it is important to note that business income (specifically from a partnership or S corporation) reported on an individual IRS Form 1040 may not necessarily represent income that has actually been distributed to the borrower. The fundamental exercise, when conducting a self-employment income cash flow analysis, is to determine the amount of income that can be relied on by the borrower in qualifying for their personal mortgage obligation. When underwriting these borrowers, it is important to review business income distributions that have been made or could be made to these borrowers while maintaining the viability of the underlying business. This analysis includes assessing the stability of business income and the ability of the business to continue to generate sufficient income to enable these borrowers to meet their financial obligations.

#### **Factors to Consider for a Self-Employed Borrower**

Any individual who has a 25% or greater ownership interest in a business is considered to be self-employed.

The following factors must be analyzed before approving a mortgage for a self-employed borrower:

- the stability of the borrower's income,
- the location and nature of the borrower's business,
- the demand for the product or service offered by the business,
- the financial strength of the business, and
- the ability of the business to continue generating and distributing sufficient income to enable the borrower to make the payments on the requested mortgage.

#### **Length of Self-Employment**

Fannie Mae generally requires lenders to obtain a two-year history of the borrower's prior earnings as a means of demonstrating the likelihood that the income will continue to be received.

However, a person who has a shorter history of self-employment — 12 to 24 months — may be considered, as long as the borrower's most recent signed federal income tax returns reflect the receipt of such income at the same (or greater) level in a field that provides the same products or services as the current business or in an occupation in which he or she had similar responsibilities to those undertaken in connection with the current business. In such cases, the lender must give careful consideration to the nature of the borrower's level of experience, and the amount of debt the business has acquired.

#### **Verification of Income**

The lender may verify a self-employed borrower's employment and income by obtaining from the borrower copies of his or her signed federal income tax returns (both individual returns and in some cases, business returns) that were filed with the IRS for the past two years (with all applicable schedules attached).

Alternatively, the lender may use IRS-issued transcripts of the borrower's individual and business federal income tax returns that were filed with the IRS for the most recent two years—as long as the information provided is complete and legible and the transcripts include the information from all of the applicable schedules. (See B3-3.1-06, Requirements and Uses of IRS IVES Request for Transcript of Tax Return

Form 4506-C (12/16/2020).)

When two years of signed individual federal tax returns are provided, the lender may waive the requirement for business tax returns if:

- the borrower is using his or her own personal funds to pay the down payment and closing costs and satisfy applicable reserve requirements,
- the borrower has been self-employed in the same business for at least five years, and
- the borrower's individual tax returns show an increase in self-employment income over the past two years.

For certain loan casefiles DU will issue a message permitting only one year of personal and business tax returns, provided lenders document the income by:

- obtaining signed individual and business federal income tax returns for the most recent year,
- confirming the tax returns reflect at least 12 months of self-employment income, and
- completing Fannie Mae's *Cash Flow Analysis* (Form 1084) or any other type of cash flow analysis form that applies the same principles.

### Analysis of Borrower's Personal Income

The lender must prepare a written evaluation of its analysis of a self-employed borrower's personal income, including the business income or loss, reported on the borrower's individual income tax returns. The purpose of this written analysis is to determine the amount of stable and continuous income that will be available to the borrower. This is not required when a borrower is qualified using only income that is not derived from self-employment and self-employment is a secondary and separate source of income (or loss). Examples of income not derived from self-employment include salary and retirement income.

The lender may use Form 1084 or any other type of cash flow analysis, including automated tools, that applies the same principles as Fannie Mae's form.

A copy of the written analysis must be included as part of any loan application package that the lender submits to Fannie Mae for a mortgage that is selected for a post-purchase quality control review.

The lender may use a Fannie Mae-approved vendor tool to complete the written analysis and calculate self-employment income. The lender may receive representation and warranty enforcement relief of the calculated amount if certain requirements are met. See A2-2-04, Limited Waiver and Enforcement Relief of Representations and Warranties for Mortgages Submitted to DU (12/04/2018) and Fannie Mae's website for the list of Approved Vendor Tools.

### Analysis of Borrower's Business Income

When a borrower is relying upon self-employed income to qualify for a mortgage and the requirements that permit the lender to waive business tax returns are not met, the lender must prepare a written evaluation of its analysis of the borrower's business income. The lender must evaluate the borrower's business through its knowledge of other businesses in the same industry to confirm the stability of the borrower's business income and estimate the potential for long-term earnings.

The purpose of this analysis is to:

- consider the recurring nature of the business income, including identification of pass-through income that may require additional evaluation;
- measure year-to-year trends for gross income, expenses, and taxable income for the business;
- determine (on a yearly or interim basis) the percentage of gross income attributed to expenses and taxable income; and
- determine a trend for the business based on the change in these percentages over time.

The lender may use Fannie Mae's *Comparative Income Analysis* (Form 1088) or any other method of trend analysis that enables it to determine a business's viability, as long as the method used fairly presents the viability of the business and results in a degree of accuracy and a conclusion that is comparable to that which would be reached by use of Form 1088.

A copy of the written analysis and conclusions must be retained in the individual mortgage file.

### Use of Business Assets

When a borrower intends to use business assets as funds for the down payment, closing costs, and/or financial reserves, the lender must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business. In order to assess the impact, the lender may require a level of documentation greater than what is required to evaluate the borrower's business income (for example, several months of recent business asset statements in order to see cash flow needs and trends over time, or a current balance sheet). This may be due to the amount of time that has elapsed since the most recent tax return filing, or the lender's need for information to perform its analysis. See B3-4.2-02, Depository Accounts (12/06/2016), for additional information on business assets.

### Income Verification for Self-Employed Co-Borrowers

When co-borrower income that is derived from self-employment is not being used for qualifying purposes, the lender is not required to document or evaluate the co-borrower's self-employment income (or loss). Any business debt on which the borrower is personally obligated must be included in the total monthly obligations when calculating the debt-to-income ratio.

### Verbal Verification of Employment

For requirements regarding verbal VOs, see B3-3.1-07, Verbal Verification of Employment (10/02/2018).

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2015-09	August 25, 2015

Announcement SEL-2014-16	December 16, 2014
Announcement SEL-2013-03	April 9, 2013
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-02	March 2, 2010
Announcement -2009-19	June 8, 2009

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### B3-3.2-02, Business Structures (12/16/2014)

#### Introduction

This topic contains information on various types of business structures, including:

- Overview
- Sole Proprietorships
- Partnerships
- Limited Liability Companies
- S Corporations
- Corporations

#### Overview

The legal structure of a business determines the following:

- the way business income or loss is reported to the IRS,
- the taxes that are paid,
- the ability of the business to accumulate capital, and
- the extent of the owner's liability.

There are five principal business structures: sole proprietorships, partnerships, limited liability companies (LLCs), S corporations, and corporations. Knowledge of the structure of a self-employed borrower's business will assist the lender in analyzing and evaluating the stability of the business and the degree of the borrower's involvement.

**Note:** Refer to B3-3.2-03, IRS Forms Quick Reference (12/16/2020), for a summary of the IRS forms referenced in this section and their full titles.

#### Sole Proprietorships

A sole proprietorship is an unincorporated business that is individually owned and managed. The individual owner has unlimited personal liability for all debts of the business. If the business fails, the borrower not only will have to replace his or her lost income, but also will be expected to satisfy the outstanding obligations of the business. Since no distinction is made between the owner's personal assets and the assets used in the business, creditors may take either (or both) to satisfy the borrower's business obligations.

The financial success or failure of this type of business depends solely on the owner's ability to obtain capital and to manage the various aspects of the business. Poor management skills or an inability to secure capital to keep the business running will compromise the continuance of the borrower's business (and income). The owner's death terminates the business and may cause the assets to be placed into probate, thus delaying the disposition of the assets to creditors and heirs.

The income, expenses, and taxable profits of a sole proprietorship are reported on the owner's IRS Form 1040, Schedule C, and are taxed at the tax rates that apply to individuals. (See B3-3.3-03, Income or Loss Reported on IRS Form 1040, Schedule C (04/01/2009).)

When evaluating a sole proprietorship, the lender must:

- review the owner's most recent signed federal income tax returns to ensure that there is sufficient and stable cash flow to support both the business and the payments for the requested mortgage, and
- determine whether the business can accommodate the withdrawal of assets or revenues should the borrower need them to pay the mortgage payment and/or other personal expenses.

#### Partnerships

A partnership is an arrangement between two or more individuals who have pooled their assets and skills to form a business and who will share profits and losses according to predetermined proportions that are set out in the partnership agreement. A partnership may be either a general partnership or a limited partnership:

- **General Partnership** — Under a general partnership, each partner has responsibility for running the business, is personally liable for the debts of the entire business, and is responsible for the actions of every other partner (unless otherwise specified in the partnership agreement). A general partnership is dissolved immediately on the death, withdrawal, or insolvency of any of the partners, although the personal liability to partnership creditors exists even after the partnership is dissolved. However, the partnership's assets will first be applied to the creditors of the business and the partners' individual assets will be first be applied to their personal creditors, with any surplus in a partner's personal assets then being applied to the remaining business creditors.
- **Limited Partnership** — Under a limited partnership, a limited partner has limited liability based on the amount he or she invested in the partnership, does not typically participate in the management and operation of the business, and has limited decision-making ability. A limited partnership will have at least one general partner who manages the business and is personally liable for the debts of the entire business. A limited partner's death, withdrawal, or insolvency does not dissolve the partnership. Because limited partnerships often are formed as tax shelters, it is more likely that IRS Form 1065, Schedule K-1, will reflect a loss instead of income. In such cases, the borrower's ability to deduct the loss will be limited by the "at risk" amount of his or her limited partnership interest (and will probably be subject to passive loss limitations).

The partnership must report its profit or loss on IRS Form 1065 and each partner's share of the profit or loss on IRS Form 1065, Schedule K-1; however, the partnership pays no tax on the partnership income.

Each partner uses the information from IRS Form 1065, Schedule K-1, to report his or her share of the partnership's net profit or loss (and special deductions and credits) on his or her IRS Form 1040—whether or not the partner receives a cash distribution from the partnership. Individual partners pay taxes on their proportionate share of the net partnership income at their individual tax rates.

To quantify the level of the borrower's financial risk, the lender must:

- determine whether the borrower has guaranteed any loans obtained by the partnership (other than loans that are considered as nonrecourse debt or qualified nonrecourse debt),
- determine if the borrower received a distribution from the partnership, and
- determine the borrower's share of non-cash expenses that can be added back to the cash flow of the partnership business.

For additional information, see the following:

- B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)
- B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019)

### Limited Liability Companies

A limited liability company (LLC) is a hybrid business structure that is designed to offer its member-owners the tax efficiencies of a partnership and the limited liability advantages of a corporation. The member-owners of the LLC (or their assigned managers) can sign contracts, sell assets, and make other important business decisions. The LLC operating agreement may set out specific divisions of power among the member-owners (or managers). Although the member-owners generally have limited liability, there may be some instances in which they are required to personally guarantee some of the loans that the LLC obtains. Profits from the operation of the LLC may be distributed beyond the pool of member-owners, such as by offering profit distributions to managers.

The LLC may report its profit or loss on IRS Form 1065 or IRS Form 1120S with each member-owner's share of the profit or loss on Schedule K-1, IRS Form 1065 or IRS Form 1120S; however, the LLC pays no tax on its income. Each member-owner uses the information from Schedule K-1 to report his or her share of the LLC's net profit or loss (and special deductions and credits) on his or her individual IRS Form 1040, whether or not the member-owner receives a cash distribution from the LLC. Individual member-owners pay taxes on their proportionate share of the LLC's net income at their individual tax rates.

The lender must evaluate the LLC using IRS Form 1065 or IRS Form 1120S along with the Schedule K-1, as applicable, to determine the following:

- whether the borrower actually received a cash distribution from the LLC, since profits may or may not be distributed to the individual member-owners; and
- whether the borrower has guaranteed any loans obtained by the LLC (other than loans that are considered as nonrecourse debt or qualified nonrecourse debt).

For additional information, see the following:

- B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)
- B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019)

### S Corporations

An S corporation is a legal entity that has a limited number of stockholders and elects not to be taxed as a regular corporation. Business gains and losses are passed on to the stockholders. An S corporation has many of the characteristics of a partnership. Stockholders are taxed at their individual tax rates for their proportionate share of ordinary income, capital gains, and other taxable items.

The ordinary income for an S corporation is reported on IRS Form 1120S, with each shareholder's share of the income reported on IRS Form 1120S, Schedule K-1.

Because this income from the distribution of corporate earnings may or may not be distributed to the individual shareholders, the lender must determine if the borrower received a cash distribution from the S corporation.

The cash flow of an S corporation is otherwise evaluated similarly to that of a regular corporation.

For additional information, see the following:

- B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)
- B3-3.4-02, Analyzing Returns for an S Corporation (06/05/2019)

### Corporations

A corporation is a state-chartered legal entity that exists separately and distinctly from its owners (who are called stockholders or shareholders). It is the most flexible form of business organization for purposes of obtaining capital. A corporation can sue; be sued; hold, convey, or receive property; enter into contracts under its own name; and does not dissolve when its ownership changes. There are two types of corporations—publicly owned (widely held) corporations and privately owned (closely held) corporations. Because more than 50% of the outstanding stock of a privately owned corporation is owned directly or indirectly by no more than five people, the corporation has little or no access to public funds and must raise capital through institutional financing.

Although legal control of the corporation rests with its stockholders, they typically are not responsible for the day-to-day operations of the business since they elect a board of directors to manage the corporation and delegate responsibility for the day-to-day operations to the directors and officers of the company. The distribution of profits earned by the business is determined by the corporation's board of directors or other entities that have a significant financial interest in the business. However, the profits usually are filtered down to the owners in the form of dividends. Since a stockholder is not personally liable for the debts of the corporation, losses are limited to his or her individual investment in the corporation's stock.

Corporations must report income and losses on IRS Form 1120 and pay taxes on the net income. The corporation distributes profits to its shareholders in the form of dividends, which it reports on IRS Form 1099-DIV. The shareholders must then report the dividends as income on their individual IRS Form 1040.

For additional information, see:

- B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)
- B3-3.4-03, Analyzing Returns for a Corporation (06/05/2019)

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2014-16	December 16, 2014
Announcement SEL-2010-02	March 2, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.2, Self-Employment Income > B3-3.2-03, IRS Forms Quick Reference (12/16/2020)

**REVISION HISTORY 09/30/2014**

**REVISION NUMBER:** 09302014      **DATE:** 09/30/2014

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

**B3-3.2-03, IRS Forms Quick Reference (09/30/2014)**

**Introduction**

This topic provides information on IRS tax forms.

**IRS Forms Quick Reference**

The following table lists the IRS forms referenced in this section and provides the full titles.

IRS Form Number	Title
Form 990	<i>Return of Organization Exempt From Income Tax Form</i>
Form 1040	<i>U.S. Individual Income Tax Return</i>
Form 1040, Schedule B	<i>Interest and Ordinary Dividends</i>
Form 1040, Schedule C	<i>Profit or Loss from Business (Sole Proprietorship)</i>
Form 1040, Schedule D	<i>Capital Gains and Losses</i>
Form 1040, Schedule E	<i>Supplemental Income and Loss</i>
Form 1040, Schedule F	<i>Profit or Loss From Farming</i>
Form 1065	<i>U.S. Return of Partnership Income</i>
Form 1065, Schedule K-1	<i>Partner's Share of Income, Deductions, Credits, etc.</i>
Form 1099-A	<i>Acquisition or Abandonment of Secured Property</i>
Form 1099-C	<i>Cancellation of Debt</i>
Form 1099-DIV	<i>Dividends and Distributions</i>
Form 1099-MISC	<i>Miscellaneous Income</i>
Form 1120	<i>U.S. Corporation Income Tax Return</i>
Form 1120-S	<i>U.S. Income Tax Return for an S Corporation</i>
Form 1120-S, Schedule K-1	<i>Shareholder's Share of Income, Deductions, Credits, etc.</i>
Form 2106	<i>Employee Business Expenses</i>
Form 4506-T	<i>Request for Transcript of Tax Return</i>
Form 4506	<i>Request for Copy of Tax Return</i>
Form 4797	<i>Sales of Business Property</i>
Form 6252	<i>Installment Sale Income</i>
Form 8821	<i>Tax Information Authorization</i>
Form 8825	<i>Rental Real Estate Income and Expenses of a Partnership or an S Corporation</i>
Form W-4	<i>Employee's Withholding Allowance Certificate</i>

**Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2014-12	September 30, 2014

**B3-3.2-03, IRS Forms Quick Reference (12/16/2020)**

**Introduction**

This topic provides information on IRS tax forms.

**IRS Forms Quick Reference**

The following table lists the IRS forms referenced in this section and provides the full titles.

IRS Form Number	Title
Form 990	<i>Return of Organization Exempt From Income Tax Form</i>
Form 1040	<i>U.S. Individual Income Tax Return</i>
Form 1040, Schedule B	<i>Interest and Ordinary Dividends</i>
Form 1040, Schedule C	<i>Profit or Loss from Business (Sole Proprietorship)</i>
Form 1040, Schedule D	<i>Capital Gains and Losses</i>
Form 1040, Schedule E	<i>Supplemental Income and Loss</i>
Form 1040, Schedule F	<i>Profit or Loss From Farming</i>
Form 1065	<i>U.S. Return of Partnership Income</i>
Form 1065, Schedule K-1	<i>Partner's Share of Income, Deductions, Credits, etc.</i>
Form 1099-A	<i>Acquisition or Abandonment of Secured Property</i>
Form 1099-C	<i>Cancellation of Debt</i>
Form 1099-DIV	<i>Dividends and Distributions</i>
Form 1099-MISC	<i>Miscellaneous Income</i>
Form 1120	<i>U.S. Corporation Income Tax Return</i>
Form 1120-S	<i>U.S. Income Tax Return for an S Corporation</i>
Form 1120-S, Schedule K-1	<i>Shareholder's Share of Income, Deductions, Credits, etc.</i>
Form 2106	<i>Employee Business Expenses</i>
Form 4506-C	<i>IVES Request for Transcript of Tax Return</i>
Form 4797	<i>Sales of Business Property</i>
Form 6252	<i>Installment Sale Income</i>
Form 8825	<i>Rental Real Estate Income and Expenses of a Partnership or an S Corporation</i>
Form W-4	<i>Employee's Withholding Allowance Certificate</i>

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2014-12	September 30, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-01, General Information on Analyzing Individual Tax Returns (06/05/2019)

### B3-3.3-01, General Information on Analyzing Individual Tax Returns (06/05/2019)

#### Introduction

This topic contains general information on analyzing individual tax returns.

#### Analyzing Individual Tax Returns

In analyzing a self-employed borrower's personal income, the lender should focus on earnings trends and the actual sources of the income, not just on the total amount of the income. The lender must confirm the stability and likelihood of continuance for each source of income that the borrower reports on his or her IRS Form 1040. The lender should not include any income that does not appear to be stable or likely to continue. The lender should, however, consider all recurring income that the borrower can expect to continue receiving over time.

Income may be considered as recurring if the loan application package does not include any specific indication of an upcoming change in the borrower's employment or income, the borrower's employment history has no gaps or other significant fluctuations in income, and any income received under a contractual agreement (other than an "at will" contract) will continue to be received for at least three years.

Examples of recurring income include:

- regular salaries or wages,
- bonus or commission income that has been received on a consistent basis,
- interest income from long-term investments that are not being liquidated in connection with the mortgage transaction, and
- earnings from the operation of the borrower's business.

Any nonrecurring loss (such as an extraordinary one-time expense) should not be included in the cash flow analysis; therefore, in developing the borrower's qualifying income, the lender should adjust the borrower's cash flow by the amount of any nonrecurring loss.

#### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-05	June 05, 2019
Announcement SEL-2015-09	August 25, 2015

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-02, Income Reported on IRS Form 1040 (05/15/2012)

### **B3-3.3-02, Income Reported on IRS Form 1040 (05/15/2012)**

#### **Introduction**

This topic contains information on income reported on IRS Form 1040, including:

- Overview
- Wages, Salary, and Tips
- Interest and Dividend Income
- State and Local Tax Refunds
- Alimony Received
- IRA Distributions, Pensions and Annuities, and Social Security Benefits
- Unemployment Compensation
- Other Income (or Loss)

#### **Overview**

To get an accurate picture of the borrower's cash flow, the lender will need to make certain adjustments to some of the income (or loss) that the borrower reported on IRS Form 1040 since it may not be recurring income. The lender also may need to further analyze the accompanying tax schedules or supplemental tax forms.

This section describes how the lender should treat various components of the income (or loss) that a self-employed borrower reported on IRS Form 1040 in its cash flow analysis.

**Note:** Eligibility criteria for accepting income from specific non-business sources is generally the same as that for salaried or commissioned borrowers (see B3-3.1-01, General Income Information (12/16/2020)).

#### **Wages, Salary, and Tips**

If an amount is shown for wages, salary, or tips for a self-employed borrower, it may mean:

- the borrower operates as a corporation and pays himself or herself a salary or
- the borrower's spouse is employed and receives a salary (either from the borrower's business or from another employer).

If the income relates to the borrower's spouse who is employed by another company and the income will be used in qualifying for the mortgage, the spouse's income must be verified directly with his or her employer since it may be more appropriate to use the spouse's current earnings in underwriting the mortgage. Any income that is based on current earnings or that will not be used for qualifying purposes should be deducted from the borrower's cash flow.

#### **Interest and Dividend Income**

The taxable interest and dividend income that is reported on IRS Form 1040, Schedule B, may be counted as stable income only if it has been received for the past two years. However, the income cannot be counted if the borrower is using the interest-bearing or dividend-producing asset as the source of the down payment or closing costs.

Any taxable interest or dividend income that is not recurring must be deducted from the borrower's cash flow.

Tax-exempt interest income may be counted as stable income only if it has been received for the past two years and is expected to continue. If so, this income can be added to the borrower's cash flow.

#### **State and Local Tax Refunds**

Taxable state and local tax refunds, credits, or offsets of state and local income taxes should not be used as qualifying income since the income was accounted for in the previous year's tax returns. Therefore, the borrower's cash flow must be adjusted accordingly.

#### **Alimony Received**

Alimony may be accepted as qualifying income if it meets the requirements described in B3-3.1-09, Other Sources of Income (12/16/2020). Any reported alimony received that is determined to be nonrecurring must be deducted from the borrower's total income reported on IRS Form 1040.

#### **IRA Distributions, Pensions and Annuities, and Social Security Benefits**

Income received from IRA distributions, pensions, annuities, and Social Security benefits may be accepted as qualifying income. See B3-3.1-09, Other Sources of Income (12/16/2020), for specific requirements.

The nontaxable portion of such recurring income must be added to the borrower's cash flow. The tax-exempt portion of income from these sources may be increased to reflect the tax savings, as described in B3-3.1-01, General Income Information (12/16/2020). If the income from these sources is determined to be nonrecurring, the income must be deducted from the borrower's cash flow.

#### **Unemployment Compensation**

Unemployment compensation may be considered as acceptable qualifying income if it meets the requirements described in B3-3.1-09, Other Sources of Income (12/16/2020). Any reported unemployment compensation that is determined to be nonrecurring must be deducted from the

borrower's cash flow.

### Other Income (or Loss)

If the borrower reported income from other sources, the lender must verify that the income is an eligible source for qualifying purposes per the requirements described in B3-3.1-09, Other Sources of Income (12/16/2020), for the applicable income source. Income that is determined to be nonrecurring or ineligible for qualifying purposes must be deducted from the borrower's cash flow. If the borrower reported any nonrecurring losses, the borrower's cash flow should be increased by the amount of the losses.

### Related Announcements

The table below provides references to the Announcements that have been released that are related to this topic.

Announcements	Issue Date
Announcement SEL-2012-04	May 15, 2012

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-03, Income or Loss Reported on IRS Form 1040, Schedule C (04/01/2009)

### B3-3.3-03, Income or Loss Reported on IRS Form 1040, Schedule C (04/01/2009)

#### Introduction

This topic contains information on income or loss reported on IRS Form 1040, Schedule C, including:

- Income (or Loss) from a Sole Proprietorship
- Recurring vs. Non-recurring Income and Expenses

#### Income (or Loss) from a Sole Proprietorship

The income (or loss) from a borrower's sole proprietorship is calculated on IRS Form 1040, Schedule C, then transferred to IRS Form 1040.

The lender may need to make certain adjustments to the net profit or loss shown on Schedule C to arrive at the borrower's cash flow. For example, Schedule C may include income that was not obtained from the profits of the borrower's business. If the lender determines that such income is not recurring, it should adjust the borrower's cash flow by deducting the nonrecurring income.

See B3-3.2-02, Business Structures (12/16/2014), for more information on sole proprietorships.

#### Recurring vs. Non-recurring Income and Expenses

The lender must determine whether income is recurring or non-recurring.

Non-recurring income must be deducted in the cash flow analysis, including any exclusion for meals and entertainment expenses reported by the borrower on Schedule C.

The following recurring items claimed by the borrower on Schedule C must be added back to the cash flow analysis: depreciation, depletion, business use of a home, amortization, and casualty losses.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-04, Income or Loss Reported on IRS Form 1040, Schedule D (11/13/2012)

### B3-3.3-04, Income or Loss Reported on IRS Form 1040, Schedule D (11/13/2012)

#### Introduction

This topic contains information on income or loss reported on IRS Form 1040, Schedule D, including:

- Overview
- Calculating Borrower Cash Flow from Schedule D and Required Documentation

#### Overview

IRS Form 1040, Schedule D, is used to report capital gains and losses. Income received from a capital gain is generally a one-time transaction; therefore, it should not usually be considered part of the borrower's stable monthly income.

#### Calculating Borrower Cash Flow from Schedule D and Required Documentation

If the income calculated on the Schedule D shows that the borrower has realized capital gains for the last two years, as may be the case when the borrower's business has a constant turnover of assets that produces regular gains, the recurring gains can be considered in determining the borrower's stable monthly income. In this case, the borrower must provide evidence of ownership of additional property or assets that can be sold if extra income is needed to make future mortgage payments.

The table below provides the requirements for calculating cash flow from Schedule D and the associated required documentation.

If ...	Then ...
recurring capital gains relate to the sale of business property,	lenders must obtain a copy of the applicable Sale of Business Property (IRS Form 4797) to support the recurring nature of the capital gains.
Schedule D includes principal payments on an installment sales contract,	lenders must obtain a copy of <ul style="list-style-type: none"><li>the Installment Sale Income (IRS Form 6252), and</li><li>the note or contract to verify that the borrower will continue to receive the payments for at least three years.</li></ul>

the capital gain on the principal payment and interest income from an installment sales contract is determined to be nonrecurring,	the amount must be deducted from the borrower's cash flow.
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**Note:** Capital losses identified on IRS Form 1040, Schedule D, do not have to be considered when calculating income or liabilities, even if the losses are recurring.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2012-13	November 13, 2012

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-05, Income or Loss Reported on IRS Form 1040, Schedule E (09/30/2014)

### B3-3.3-05, Income or Loss Reported on IRS Form 1040, Schedule E (09/30/2014)

#### Introduction

This topic contains information on income or loss reported on IRS Form 1040, Schedule E, including:

- Overview
- Royalty Income
- Rental Income

#### Overview

Income received from rents, royalties, and distributions from partnerships, corporations, estates, trusts, etc., is calculated on IRS Form 1040, Schedule E, and transferred to IRS Form 1040.

Rather than using Schedule E for income related to distributions from partnerships, corporations, estates, and trusts, the lender should rely on Schedule K-1 (see B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)).

#### Royalty Income

Schedule E should be used to determine the supplemental income to use for royalties. The lender must include the total amount of royalty payments received, and must document the borrower's receipt of royalty income for 12 months and the likelihood of continued receipt of such income for at least three years (see B3-3.1-09, Other Sources of Income (12/16/2020))

#### Rental Income

If rental income is reported on Schedule E, only the rental income that relates to properties shown on the Schedule of Real Estate Owned on the borrower's loan application should be included.

All regular and ongoing expenses for the properties, such as maintenance, advertising, management fees, utilities, homeowners' association dues, and supply costs, should be subtracted from the borrower's cash flow.

Depending on the approach used to calculate cash flow, adjustments will need to be made for depreciation and any one-time extraordinary expenses, such as the costs of repairing damage that resulted from a natural disaster.

In most situations, the full amount of the mortgage payment for a rental property will be factored into the net rental income calculation, but it may also be counted as part of the liabilities that are considered in the calculation of the borrower's total debt-to-income ratio. Therefore, the lender must add back any portion of the mortgage payment, including interest, taxes, and insurance, necessary to avoid double counting of these expenses.

The lender must pay particular attention to the effect of "passive loss" limitations or prior "carryovers" related to the borrower's rental properties and, depending on the method it uses for the cash flow analysis, make any special adjustments necessary to account for them.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2014-12	September 30, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-06, Income or Loss Reported on IRS Form 1040, Schedule F (04/01/2009)

### B3-3.3-06, Income or Loss Reported on IRS Form 1040, Schedule F (04/01/2009)

#### Introduction

This topic contains information on income or loss reported on IRS Form 1040, Schedule F.

#### Income or Loss Reported on IRS Form 1040, Schedule F

Income received from farming is calculated on IRS Form 1040, Schedule F, and transferred to IRS Form 1040.

**Note:** Other income on Schedule F may represent income that is not obtained from the borrower's farming operations.

The lender may need to make certain adjustments to the net income amount that was transferred to IRS Form 1040. For example, certain federal agricultural program payments, co-op distributions, and insurance or loan proceeds are not fully taxable, so they would not be reported on IRS Form 1040. These income sources may or may not be stable or continuous and could be a one-time occurrence.

If the lender verifies that the net income amounts that were transferred to IRS Form 1040 are stable, consistent, and continuing, the borrower's cash flow must be adjusted by the nontaxable portion of any recurring income from these sources. Otherwise, the income must be deducted from the borrower's cash flow.

The lender can adjust the borrower's cash flow by adding the amount of any deductions the borrower claimed on Schedule F for depreciation, amortization, casualty loss, depletion, or business use of his or her home.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.3, Self-Employment Documentation Requirements for an Individual > B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)

**B3-3.3-07, Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1 (06/28/2016)**

**Introduction**

This topic contains information on income or loss reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1, including:

- Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1
- Documentation Requirements

**Income or Loss Reported on IRS Form 1065 or IRS Form 1120S, Schedule K-1**

The version of Schedule K-1 that is utilized to report a borrower's share of income (or loss) is based on how the business reports earnings for tax purposes:

- partnership — reported on IRS Form 1065, Schedule K-1;
- S corporation — reported on IRS Form 1120S, Schedule K-1; and
- LLC — reported on either IRS Form 1065 or IRS Form 1120S, Schedule K-1, depending on how the federal income tax returns are filed for the LLC.

The lender must use caution when including income that the borrower draws from the borrower's partnership or S corporation as qualifying income. Ordinary income, net rental real estate income, and other net rental income reported on Schedule K-1 may be included in the borrower's cash flow provided the lender can confirm that the business has adequate liquidity to support the withdrawal of earnings, as described below:

- If the borrower has a two-year history of receiving "guaranteed payments to the partner" from a partnership or an LLC, these payments can be added to the borrower's cash flow.
- If the Schedule K-1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to the income or adequate business liquidity is required. But if the Schedule K-1 does not reflect a documented, stable history, then the lender must confirm adequate business liquidity, as discussed below.

If business tax returns are required, then the lender must consider the type of business structure and analyze the business returns, according to the requirements described in B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower (10/24/2016).

The lender may use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings. When business tax returns are provided, for example, the lender may calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities.

It is important that the lender select a business liquidity formula based on how the business operates. For example:

- The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.  
Quick Ratio = (current assets — inventory) ÷ current liabilities
- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.  
Current Ratio = current assets ÷ current liabilities

For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

**Documentation Requirements**

The following table describes the documentation that the borrower must provide. The borrower must select one item from each row.

✓	Documentation Requirements
	<ul style="list-style-type: none"> <li>• the most recent two years of signed individual federal income tax returns—IRS Form 1040; or</li> <li>• the most recent one year of signed individual federal income tax returns, if permitted by DU</li> </ul>
	<ul style="list-style-type: none"> <li>• the most recent two years of IRS Schedule K-1; or</li> <li>• the most recent year IRS Schedule K-1, if permitted by DU</li> </ul>
	<ul style="list-style-type: none"> <li>• the most recent two years of business federal income tax returns (IRS Form 1065 or IRS Form 1120S), unless the requirements to waive business tax returns have been met; or</li> <li>• the most recent one year of business federal income tax returns, if permitted by DU</li> </ul>

**Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2014-16	December 16, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.4, Self-Employment Documentation Requirements for a Business > B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019)

### **B3-3.4-01, Analyzing Partnership Returns for a Partnership or LLC (06/05/2019)**

#### **Introduction**

This topic contains information on analyzing partnership returns for a partnership or LLC, including:

- Overview
- Evaluating the Business Income
- Borrower's Proportionate Share of Income or Loss
- Adjustments to Business Cash Flow
- Income from Partnerships, LLCs, Estates, and Trusts

#### **Overview**

Partnerships and some LLCs use IRS Form 1065 for filing informational federal income tax returns for the partnership or LLC. The partner's or member-owner's share of income (or loss) is carried over to IRS Form 1040, Schedule E. See B3-3.2-02, Business Structures (12/16/2014), for more information on partnerships and LLCs.

A borrower with an ownership interest in a partnership or LLC may receive income in the form of wages or other compensation from the partnership or LLC in addition to the borrower's proportionate share of income (or loss) reported on the Schedule K-1.

#### **Evaluating the Business Income**

When the borrower has 25% or more ownership interest in the business and business tax returns are required, the lender must perform a business cash flow analysis and evaluate the overall financial position of the borrower's business to determine whether

- income is stable and consistent, and
- sales and earnings trends are positive.

If the business does not meet these standards, business income cannot be used to qualify the borrower.

#### **Borrower's Proportionate Share of Income or Loss**

The borrower's proportionate share of income or loss is based on the borrower's partnership percentage of Ending Capital in the business as shown on IRS Form 1065, Schedule K-1.

The lender can only consider the borrower's proportionate share of the business income or loss after making the adjustments to the business cash flow analysis discussed below.

#### **Adjustments to Business Cash Flow**

Items that can be added back to the business cash flow include depreciation, depletion, amortization, casualty losses, and other losses that are not consistent and recurring.

The following items should be subtracted from the business cash flow:

- travel and meals exclusion,
- other reported income that is not consistent and recurring, and
- the total amount of obligations on mortgages, notes, or bonds that are payable in less than one year.

These adjustments are not required for lines of credit or if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

#### **Income from Partnerships, LLCs, Estates, and Trusts**

Income from partnerships, LLCs, estates, or trusts can only be considered if the lender obtains documentation, such as the Schedule K-1, verifying that

- the income was actually distributed to the borrower, or
- the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

The lender may use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings. When business tax returns are provided, for example, the lender may calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities.

It is important that the lender select a business liquidity formula based on how the business operates. For example:

- The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.  
Quick Ratio =  $(\text{current assets} - \text{inventory}) \div \text{current liabilities}$
- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.

Current Ratio = current assets ÷ current liabilities

For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-05	June 05, 2019
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2014-16	December 16, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.4, Self-Employment Documentation Requirements for a Business > B3-3.4-02, Analyzing Returns for an S Corporation (06/05/2019)

### B3-3.4-02, Analyzing Returns for an S Corporation (06/05/2019)

#### Introduction

This topic contains information on analyzing returns for an S corporation, including:

- Overview
- Evaluating the Business Income
- Borrower's Proportionate Share of Income or Loss
- Adjustments to Business Cash Flow

#### Overview

S corporations and some LLCs pass gains and losses on to their shareholders, who are then taxed at the tax rates for individuals. S corporations and some LLCs use IRS Form 1120S, Schedule K-1, for filing federal income tax returns for the corporation. The shareholder's share of income or loss is carried over to IRS Form 1040, Schedule E. See B3-3.2-02, Business Structures (12/16/2014), for more information on S corporations. A borrower with an ownership interest in an S corporation or LLC may receive income in the form of wages or dividends in addition to his or her proportionate share of business income (or loss) reported on Schedule K-1.

#### Evaluating the Business Income

When the borrower has 25% or more ownership interest in the business, the lender must perform a business cash flow analysis in order to evaluate the overall financial position of the business and confirm

- the business income is stable and consistent, and
- the sales and earnings trends are positive.

If the business does not meet these standards, business income cannot be used to qualify the borrower.

#### Borrower's Proportionate Share of Income or Loss

The borrower's proportionate share of income or loss is based on the borrower's (shareholder) percentage of stock ownership in the business for the tax year as shown on IRS Form 1120S, Schedule K-1. The cash flow analysis should consider only the borrower's proportionate share of the business income (or loss), taking into account any adjustments to the business income that are discussed below. Business income may only be used to qualify the borrower if the lender obtains documentation verifying that

- the income was actually distributed to the borrower, or
- the business has adequate liquidity to support the withdrawal of earnings. If the Schedule K-1 provides this confirmation, no further documentation of business liquidity is required.

The lender may use discretion in selecting the method to confirm that the business has adequate liquidity to support the withdrawal of earnings. When business tax returns are provided, for example, the lender may calculate a ratio using a generally accepted formula that measures business liquidity by deriving the proportion of current assets available to meet current liabilities.

It is important that the lender select a business liquidity formula based on how the business operates. For example:

- The Quick Ratio (also known as the Acid Test Ratio) is appropriate for businesses that rely heavily on inventory to generate income. This test excludes inventory from current assets in calculating the proportion of current assets available to meet current liabilities.

Quick Ratio = (current assets — inventory) ÷ current liabilities

- The Current Ratio (also known as the Working Capital Ratio) may be more appropriate for businesses not relying on inventory to generate income.

Current Ratio = current assets ÷ current liabilities

For either ratio, a result of one or greater is generally sufficient to confirm adequate business liquidity to support the withdrawal of earnings.

#### Adjustments to Business Cash Flow

Items that can be added back to the business cash flow include depreciation, depletion, amortization, casualty losses, and other losses that are not consistent and recurring.

The following items should be subtracted from the business cash flow:

- travel and meals exclusion,
- other reported income that is not consistent and recurring, and

- the total amount of obligations on mortgages, notes, or bonds that are payable in less than one year.

These adjustments are not required for lines of credit or if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-05	June 05, 2019
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2014-16	December 16, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.4, Self-Employment Documentation Requirements for a Business > B3-3.4-03, Analyzing Returns for a Corporation (06/05/2019)

### B3-3.4-03, Analyzing Returns for a Corporation (06/05/2019)

#### Introduction

This topic contains information on analyzing returns for corporations, including:

- Overview
- Corporate Fiscal Year
- Determining the Corporation's Financial Position
- Borrower's Share of Income or Loss
- Adjustments to Cash Flow

#### Overview

Corporations use IRS Form 1120 to report their taxes. See B3-3.2-02, Business Structures (12/16/2014), for more information on corporations.

#### Corporate Fiscal Year

When funds from a corporation that operates on a fiscal year that is different from the calendar year are used in qualifying a self-employed borrower, the lender must make time adjustments to relate the corporate income to the borrower's individual tax return, which is on a calendar year basis.

#### Determining the Corporation's Financial Position

After determining the income available to the borrower for qualifying purposes, the lender must evaluate the overall financial position of the corporation. Ordinary income from the corporation can be used to qualify the borrower only if the following requirements are met:

- the business income must be stable and consistent,
- the sales and earnings trends must be positive, and
- the business must have adequate liquidity to support the borrower's withdrawals of cash without having severe negative effects.

#### Borrower's Share of Income or Loss

The cash flow analysis can only consider the borrower's share of the business income or loss, taking into consideration adjustments to business income provided below. Earnings may not be used unless the borrower owns 100% of the business.

#### Adjustments to Cash Flow

Items that can be added back to the business cash flow include depreciation, depletion, amortization, casualty losses, net operating losses, and other special deductions that are not consistent and recurring.

The following items should be subtracted from the business cash flow:

- travel and meals exclusion,
- tax liability and amount of any dividends, and
- the total amount of obligations on mortgages, notes, or bonds that are payable in less than one year. These adjustments are not required if there is evidence that these obligations roll over regularly and/or the business has sufficient liquid assets to cover them.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-05	June 05, 2019

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.4, Self-Employment Documentation Requirements for a Business > B3-3.4-04, Analyzing Profit and Loss Statements (04/01/2009)

## B3-3.4-04, Analyzing Profit and Loss Statements (04/01/2009)

### Introduction

This topic contains information on analyzing profit and loss statements.

### Analyzing Profit and Loss Statements

The lender may use a profit and loss statement—audited or unaudited—for a self-employed borrower's business to support its determination of the stability or continuance of the borrower's income. A typical profit and loss statement has a format similar to IRS Form 1040, Schedule C.

A year-to-date profit and loss statement is not required for most businesses, but if the borrower's loan application is dated more than 120 days after the end of the business's tax year, the lender may choose to require this document if it believes that it is needed to support its determination of the stability or continuance of the borrower's income.

If the lender did not count the borrower's year-to-date salary or draws in determining the borrower's qualifying income, it may add them to the net profit shown on the profit and loss statement as well as adding any of the allowable adjustments it used in analyzing the tax returns for the business, such as nonrecurring income and expenses, depreciation, and depletion.

However, only the borrower's proportionate share of these items may be considered in determining the amount of income from the business that the borrower can use for qualifying purposes.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.5, DU Requirements for Income Assessment > B3-3.5-01, Income and Employment Documentation for DU (12/16/2020)

REVISION HISTORY 08/07/2019

REVISION NUMBER: 08072019 DATE: 08/07/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-3.5-01, Income and Employment Documentation for DU (08/07/2019)

### Introduction

This topic contains information on general income and employment documentation requirements for DU, including:

- General Income Documentation Requirements
- Reduced Income Documentation Requirements for High LTV Refinance Loans
- Alternative Documentation Requirements for Income Validated by the DU Validation Service
- Base Pay (Salary or Hourly) Income
- Bonus and Overtime Income
- Commission Income
- Secondary Employment Income (Second Job and Multiple Jobs)
- Self-Employment Income
- Verbal Verification of Employment
- Other/Non-Employment Income
- Temporary Leave Income
- Nontaxable Income

### General Income Documentation Requirements

DU indicates the minimum income verification documentation required to process a loan application. This level of documentation may not be adequate for every borrower and every situation. The lender must determine whether additional documentation is warranted. If the lender is unable to determine the stability of the borrower's income on the basis of the available documentation, the income must be removed and the loan resubmitted to DU.

The standards for employment documentation are the same for DU loan casefiles as they are for manually underwritten loans. For example, paystubs, W-2s, and tax returns must meet the same requirements without regard to the underwriting method. The following information describes DU considerations for specific types of income. For additional information, see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (02/27/2018), and Section B3-3.1, Employment and Other Sources of Income.

**Note:** Only actual employer information should be entered in Section IV. For example, do not enter "retired" or "homemaker" as the borrower's current employer.

### Reduced Income Documentation Requirements for High LTV Refinance Loans

DU offers a reduced level of income documentation for high LTV refinance loans. Refer to B5-7-02, High LTV Refinance Underwriting, Documentation, and Collateral Requirements for the New Loan (08/07/2018), for additional information.

### Alternative Documentation Requirements for Income Validated by the DU Validation Service

When a component of the loan file is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation requirement may differ from those described below. See B3-2-02, DU Validation Service (10/07/2020).

### Base Pay (Salary or Hourly) Income

DU will require the following:

- a completed *Request for Verification of Employment* (Form 1005), or
- the borrower's recent paystub and IRS W-2 forms covering the most recent one-year period.

### Bonus and Overtime Income

DU will require the following:

- a completed Form 1005, or

- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

### Commission Income

DU will require the following:

- a completed Form 1005, or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

### Secondary Employment Income (Second Job and Multiple Jobs)

When the second job income is not from self-employment, DU will require the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

**Note:** The income from any second or multiple jobs must be included in the Base Income field in Section V.

### Self-Employment Income

For DU loan casefiles where two years of the most recent signed personal and two years of the most recent signed business federal income tax returns are required, business tax returns do not have to be provided unless the business is a corporation, an S corporation, a limited liability company, or a partnership. Under certain conditions, the requirements for business tax returns may be waived.

For certain loan casefiles, DU will issue a message permitting only one year of personal and business tax returns, provided lenders document the income by

- obtaining signed individual and business federal income tax returns for the most recent year,
- confirming the tax returns reflect at least 12 months of self-employment income, and
- completing Fannie Mae's *Cash Flow Analysis* (Form 1084) or any other type of cash flow analysis form that applies the same principles.

Refer to B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower (10/24/2016) for additional information about waiving the business return requirement and for required forms and calculations. A copy of the written analysis must be included in the permanent loan file.

**Note:** The net income from self-employment should be entered in the Base Income field in Section V. The lender should answer "Yes" in the self-employment indicator.

### Verbal Verification of Employment

A verbal VOE is required for each employer. For requirements regarding verbal VOEs, see B3-3.1-07, Verbal Verification of Employment (10/02/2018).

### Other/Non-Employment Income

Other/non-employment income must be entered as "Other Income" in Section V. The other income types available in DU are listed below. Income types not in the Other Income List must be entered as "Other Types of Income" (for example, housing or parsonage allowance).

Refer to B3-3.1-09, Other Sources of Income (10/02/2019), B3-3.1-05, Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (08/07/2019), and B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for information on how to verify these sources of income:

- accessory unit
- alimony or child support
- automobile expense account
- boarder income
- capital gains
- dividends/interest
- employment-related assets
- foreign income
- foster-care
- housing choice voucher program (Section 8)
- military base pay, clothes allowance, combat pay, flight pay, hazard pay, overseas pay, prop pay, quarters allowance, rations allowance, variable housing allowance. (All military income can be combined and entered as Base Income in Section V for conventional loans.)
- mortgage credit certificates
- mortgage differential payments income
- non-borrower household income
- notes receivable and installment debt
- other types of income
- pension and retirement income
- royalty payment
- seasonal income
- Schedule K-1
- Social Security disability income
- temporary leave (see data entry instructions below)
- tip income
- trust income
- unemployment and public assistance income
- VA benefits (non-education)

### Temporary Leave Income

When income from temporary leave is being used to qualify for the mortgage loan, the lender must enter the appropriate qualifying income amount into DU based on the requirements provided in B3-3.1-09, Other Sources of Income (10/02/2019).

- If the borrower **will** return to work as of the first mortgage payment date, the lender can consider the borrower's regular employment income in qualifying and must enter the income into DU using the applicable income type.
- If the borrower **will not** return to work as of the first mortgage payment date, but is able to qualify using the lesser of the borrower's temporary leave income (if any) or regular employment income, that "lesser of" income amount must be entered into DU. Entry of the income into DU depends on what was derived as the "lesser of" amount:
  - When the borrower's temporary leave income is used, enter the income amount into DU as an Other Monthly Income amount of "Temporary Leave."
  - When the borrower's regular employment income is used, enter the income amount in DU using the applicable income type.
- If the borrower's temporary leave income is less than the regular employment income and the lender is able to "supplement" the temporary income with available liquid reserves (per B3-3.1-09, Other Sources of Income (10/02/2019)), the following must be applied:
  - The lender must enter the combined temporary leave income and supplemental income from reserves in DU as an Other Monthly Income amount of "Temporary Leave." The combination of these two incomes may not exceed the borrower's regular monthly employment income.
  - As DU is not able to determine that supplemental income is being used, nor is it able to determine the amount of reserves used to supplement the temporary income, the lender must manually reduce the amount of the borrower's total liquid assets by the amount of reserves used to supplement the temporary income (in order to avoid the reserves being used for both income and assets).

### Nontaxable Income

DU does not provide any unique messaging identifying the use of adjusted gross income.

See B3-3.1-01, General Income Information (08/07/2019), for guidance on how to calculate adjusted gross income for nontaxable income. This topic also defines the requirements that nontaxable income must meet to be considered for qualifying purposes in DU. If these requirements are not met, the borrower's income must be adjusted downward.

**Note:** Certain loan origination systems offer an automatic calculation of adjusted gross income when nontaxable income types are entered in the loan application.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-02	March 2, 2010
Announcement -2009-19	June 8, 2009

### B3-3.5-01, Income and Employment Documentation for DU (12/16/2020)

#### Introduction

This topic contains information on general income and employment documentation requirements for DU, including:

- General Income Documentation Requirements
- Reduced Income Documentation Requirements for High LTV Refinance Loans
- Alternative Documentation Requirements for Income Validated by the DU Validation Service
- Base Pay (Salary or Hourly) Income
- Bonus and Overtime Income
- Commission Income
- Secondary Employment Income (Second Job and Multiple Jobs)
- Self-Employment Income
- Verbal Verification of Employment
- Other Income
- Temporary Leave Income
- Nontaxable Income

## General Income Documentation Requirements

DU indicates the minimum income verification documentation required to process a loan application. This level of documentation may not be adequate for every borrower and every situation. The lender must determine whether additional documentation is warranted. If the lender is unable to determine the stability of the borrower's income on the basis of the available documentation, the income must be removed and the loan resubmitted to DU.

The standards for employment documentation are the same for DU loan casefiles as they are for manually underwritten loans. For example, paystubs, W-2s, and tax returns must meet the same requirements without regard to the underwriting method. The following information describes DU considerations for specific types of income. For additional information, see B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020), and Section B3-3.1, Employment and Other Sources of Income.

**Note:** Only actual employer information should be entered in the employment section of the loan application. For example, do not enter "retired" or "homemaker" as the borrower's current employer.

## Reduced Income Documentation Requirements for High LTV Refinance Loans

DU offers a reduced level of income documentation for high LTV refinance loans. Refer to B5-7-02, High LTV Refinance Underwriting, Documentation, and Collateral Requirements for the New Loan (12/16/2020), for additional information.

## Alternative Documentation Requirements for Income Validated by the DU Validation Service

When a component of the loan file is validated by the DU validation service, DU will issue a message indicating the required documentation. This documentation requirement may differ from those described below. See B3-2-02, DU Validation Service (10/07/2020).

## Base Pay (Salary or Hourly) Income

DU will require the following:

- a completed *Request for Verification of Employment* (Form 1005), or
- the borrower's recent paystub and IRS W-2 forms covering the most recent one-year period.

## Bonus and Overtime Income

DU will require the following:

- a completed Form 1005, or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

## Commission Income

DU will require the following:

- a completed Form 1005, or
- the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

## Secondary Employment Income (Second Job and Multiple Jobs)

When the second job income is not from self-employment, DU will require the borrower's recent paystub and IRS W-2 forms covering the most recent two-year period.

## Self-Employment Income

For DU loan casefiles where two years of the most recent signed personal and two years of the most recent signed business federal income tax returns are required, business tax returns do not have to be provided unless the business is a corporation, an S corporation, a limited liability company, or a partnership. Under certain conditions, the requirements for business tax returns may be waived.

For certain loan casefiles, DU will issue a message permitting only one year of personal and business tax returns, provided lenders document the income by

- obtaining signed individual and business federal income tax returns for the most recent year,
- confirming the tax returns reflect at least 12 months of self-employment income, and
- completing Fannie Mae's *Cash Flow Analysis* (Form 1084) or any other type of cash flow analysis form that applies the same principles.

Refer to B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower (10/24/2016) for additional information about waiving the business return requirement and for required forms and calculations. A copy of the written analysis must be included in the permanent loan file.

**Form 1003 7/05 (rev. 6/09):** If the borrower is the business owner or is self-employed and has an ownership share of 25% or more, the self-employment indicator must be checked. DU will consider the borrower self-employed. The net income from self-employment must be entered in the Base Income field in Section V.

**Form 1003 1/2021:** If the borrower is the business owner or is self-employed, the business owner/self-employed indicator must be checked along with the percentage of ownership. DU will consider the borrower self-employed if the ownership share is 25% or more, or if the ownership share is not completed but the business owner/self-employed indicator is checked. The lender's calculated net income (or loss) from self-employment must also be entered.

## Verbal Verification of Employment

A verbal VOE is required for each employer. For requirements regarding verbal VOEs, see B3-3.1-07, Verbal Verification of Employment (10/02/2018).

## Other Income

Other income must be entered in the loan application. DU supports a number of other income types. Income types not available in DU must be entered as "Other" income.

Refer to B3-3.1-09, Other Sources of Income (12/16/2020), B3-3.1-05, Secondary Employment Income (Second Job and Multiple Jobs) and

Seasonal Income (08/07/2019), and B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for information on eligibility and verification of other sources of income.

### Temporary Leave Income

When income from temporary leave is being used to qualify for the mortgage loan, the lender must enter the appropriate qualifying income amount into DU based on the requirements provided in B3-3.1-09, Other Sources of Income (12/16/2020).

- If the borrower **will** return to work as of the first mortgage payment date, the lender can consider the borrower's regular employment income in qualifying and must enter the income into DU using the applicable income type.
- If the borrower **will not** return to work as of the first mortgage payment date, but is able to qualify using the lesser of the borrower's temporary leave income (if any) or regular employment income, that "lesser of" income amount must be entered into DU. Entry of the income into DU depends on what was derived as the "lesser of" amount:
  - When the borrower's temporary leave income is used, enter the income amount into DU using the other income type Temporary Leave.
  - When the borrower's regular employment income is used, enter the income amount in DU using the applicable income type.
- If the borrower's temporary leave income is less than the regular employment income and the lender is able to "supplement" the temporary income with available liquid reserves (per B3-3.1-09, Other Sources of Income (12/16/2020)), the following must be applied:
  - The lender must enter the combined temporary leave income and supplemental income from reserves in DU using the other income type Temporary Leave. The combination of these two incomes may not exceed the borrower's regular monthly employment income.
  - As DU is not able to determine that supplemental income is being used, nor is it able to determine the amount of reserves used to supplement the temporary income, the lender must manually reduce the amount of the borrower's total liquid assets by the amount of reserves used to supplement the temporary income (in order to avoid the reserves being used for both income and assets).

### Nontaxable Income

DU does not provide any unique messaging identifying the use of adjusted gross income.

See B3-3.1-01, General Income Information (12/16/2020), for guidance on how to calculate adjusted gross income for nontaxable income. This topic also defines the requirements that nontaxable income must meet to be considered for qualifying purposes in DU. If these requirements are not met, the borrower's income must be adjusted downward.

**Note:** Certain loan origination systems offer an automatic calculation of adjusted gross income when nontaxable income types are entered in the loan application.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-09	August 25, 2015
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2010-16	December 1, 2010
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-02	March 2, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-3, Income Assessment > Section B3-3.5, DU Requirements for Income Assessment > B3-3.5-02, Income from Rental Property in DU (12/16/2020)

**REVISION HISTORY 10/02/2019**

**REVISION NUMBER:** 10022019      **DATE:** 10/02/2019

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-3.5-02, Income From Rental Property in DU (10/02/2019)

#### Introduction

This topic provides information on DU considerations for calculating net rental income and net cash flow for rental property, including:

- Associated Policies
- Entering Net Rental Income in DU

- Special Situations
- Documentation of Net Rental Income
- Calculation of Net Rental Income
- Entering Subject Net Cash Flow in DU
- Documentation of Subject Net Cash Flow
- Calculation of Subject Net Cash Flow

### Associated Policies

Many of the requirements that pertain to rental income are the same for loans underwritten through DU as they are for manually underwritten loans. See B3-3.1-08, Rental Income (06/03/2020), and B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015), for additional income.

### Entering Net Rental Income in DU

"Net rental income" for DU loan casefiles does not include rental income from the subject property. It applies only to rental properties already owned by the borrower. For rental income on the subject property, see Subject Net Cash Flow below.

To submit net rental income to DU, the lender can either

- Calculate the total net rental income for all rental properties (except the subject property) and enter the amount (either positive or negative) in the Net Rental field in Section V. If Real Estate Owned (REO) data is entered, DU will ignore a zero value in this Net Rental field. Therefore, the lender must enter either a positive or negative amount. In other words, if the net rental income is a "breakeven" amount, the user must enter either \$0.01 or \$-0.01. Otherwise, DU will use the value from Section VI R.
- Complete the REO data entered in the *Uniform Residential Loan Application* (Form 1003) (or in a loan origination system) for each rental property (except the subject property). DU will preliminarily calculate the net rental income using the following formula:  
(gross rental income × 75%) – property PITIA expense = net rental income

The lender should override DU's preliminary calculation, if it is different from the lender's calculation, by entering the net rental income amount directly in the Net Rental field in the Full 1003, Section VI R.

If both methods are used, DU will use the net rental income from Section V (if it is a value other than zero) and issue a message when there is a conflict of data.

If the combined total net rental income for all rental properties is positive, DU adds the net rental income to the qualifying income. If the total is negative, DU treats the loss as a liability and includes it in the debt-to-income ratio.

### Special Situations

If the borrower is purchasing a principal residence and is retaining his or her current residence as a rental property, show the current principal residence as Rental in the Property Disposition field and complete the Net Rental field in the Full 1003, Section VI R. The conversion of a principal residence to an investment property must follow the guidelines described in B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

If the borrower's principal residence is a two- to four-unit property, rental income from the principal residence can be used to qualify the borrower. With the exception of subtracting the borrower's principal mortgage payment from the gross rental income, all other calculations and documentation requirements in this section apply.

To use net rental income from a borrower's owner-occupied two- to four-unit property when the borrower is purchasing or refinancing a second home or investment property, enter the net rental income from the borrower's principal residence as Net Rental in Section V.

### Documentation of Net Rental Income

The requirements for documenting net rental income are the same for loans underwritten through DU as they are for manually underwritten loans. If the debt-to-income ratio already includes the entire rental property payment (that is, income from the property is not considered), rental income documentation is not required.

### Calculation of Net Rental Income

The calculation of net rental income is the same for loans underwritten through DU as it is for manually underwritten loans.

### Entering Subject Net Cash Flow in DU

Subject net cash flow applies to one- to four-unit investment properties and two- to four-unit principal residences secured by the subject property. DU does not calculate the subject net cash flow. The lender must calculate and enter the income in Subject Net Cash in Section V of the online loan application.

**Note:** Although negative subject net cash flow values appear to reduce the gross monthly income in Section V, DU actually treats the negative value as a liability and includes it in the debt-to-income ratio.

### Documentation of Subject Net Cash Flow

The documentation of subject net cash flow is the same for loans underwritten through DU as it is for manually underwritten loans.

If the borrower is being qualified with the entire payment, without benefit of rental income, documentation of gross monthly rent for the subject property is only required for lender reporting purposes. See A3-4-02, Data Quality and Integrity (08/07/2018), (Reporting of Gross Monthly Rent), for additional information.

### Calculation of Subject Net Cash Flow

The calculation of subject net cash flow for the security property is the same for loans underwritten through DU as it is for manually underwritten loans.

*Two- to four-unit principal residence.* Calculate the subject net cash flow, and enter this amount in Section V. It will be included in the total qualifying income. Do not subtract the PITIA from the rental income, because the PITIA is included in the total proposed mortgage payment and is considered in the qualifying ratio. Do not enter a negative subject net cash flow value, because the entire PITIA is already included in the qualifying ratio.

**Note:** Refer to B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for information about rental income from accessory units on one-unit properties and income from two- to four-unit properties secured by HomeReady mortgage loans.

*Investment properties.* Calculate the subject net cash flow. If the subject net cash flow is positive, enter the amount in Section V. It will be included in the total qualifying income. If the cash flow is negative, enter the amount in Section V as a negative value. DU will include it in the debt-to-income ratio calculation as a liability. If income from the subject property is not included in the qualifying ratios, the lender should enter the entire proposed PITIA as a negative amount in the Subject Net Cash field in Section V.

Refer to B3-3.1-08, Rental Income (06/03/2020) to determine the maximum amount of rental income that can be used for qualifying purposes.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-10	September 27, 2011
Announcement SEL-2011-03	March 31, 2011

## B3-3.5-02, Income from Rental Property in DU (12/16/2020)

### Introduction

This topic provides information about rental property in DU, including:

- Associated Policies
- Entering Net Rental Income in DU
- Conversion of Principal Residence to Investment Property
- Entering Rental Income for the Subject Property in DU
- Documentation of Rental Income

### Associated Policies

The documentation, calculation, and other requirements that pertain to rental income on an investment property or two- to four-unit principal residence are the same for loans underwritten through DU as they are for manually underwritten loans. See B3-3.1-08, Rental Income (06/03/2020), and B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015), for additional information.

### Entering Net Rental Income in DU

The following rental income policies apply to properties that are not the subject property. For rental income policies on the subject property, see **Entering Rental Income for the Subject Property in DU** below.

#### Form 1003 7/05 (rev. 6/09)

"Net rental income" for DU loan casefiles applies to rental income on properties already owned by the borrower that are not the subject property.

To submit net rental income to DU, the lender can either

- Calculate the total net rental income for all rental properties and enter the amount (either positive or negative) in the Net Rental Income field in Section V. If Real Estate Owned (REO) data is entered in Section VI R, DU will ignore a zero value in the Net Rental Income field in Section V. Therefore, the lender must enter either a positive or negative amount. If the Net Rental Income is a "breakeven" amount, the user must enter either \$0.01 or -\$0.01. Otherwise, DU will use the value from Section VI R.
- Complete the REO data in Section VI R for each rental property. If Net Rental Income is not entered, DU will calculate it using the following formula:

$$(\text{Gross rental income} - 75\%) - \text{property PITIA expense} = \text{net rental income}$$

The lender should override DU's calculation, if it is different from the lender's calculation, by entering the net rental income amount directly in the Net Rental Income field in the Full 1003, Section VI R.

If the borrower's principal residence is a two- to four-unit property (and not the subject property), net rental income can be entered in Section V or VI R. Note the following:

- The net rental income calculation is not reduced by the mortgage payment (which is always treated as a liability and included in the debt-to-income ratio).
- If Net Rental Income is not entered in VI R, DU will calculate it using the following formula:

$$\text{Gross rental income} - 75\% = \text{net rental income}$$

The lender should override DU's calculation, if it is different from the lender's calculation, by entering the Net Rental Income in VI R.

If Net Rental Income is present in both Section V and VI R, DU will use only the Net Rental Income from Section V.

If Net Rental Income is not present in Section V, and the combined total Net Rental Income for all rental properties in Section VI R is positive, DU adds the net rental income to the qualifying income and includes it in the debt-to-income ratio. If the total is negative, DU treats the loss as a liability and includes it in the debt-to-income ratio.

## Form 1003 1/2021

Properties already owned by the borrower must be entered in Section 3 along with the related existing mortgage loan(s). If Net Monthly Rental Income is not entered, DU will calculate it (if not the subject property) based on the formulas described above.

If the combined total Net Monthly Rental Income for all properties is positive, DU adds the net rental income to the qualifying income. If the total is negative, DU treats the loss as a liability and includes it in the debt-to-income ratio.

Refer to the Desktop Underwriter Job Aids (Troubleshooting - DTI Ratio Calculations) for additional details on entry of real estate and rental income.

## Conversion of Principal Residence to Investment Property

If the borrower is purchasing a principal residence and is retaining his or her current residence as a rental property, the current principal residence must be identified in the REO section of the loan application as follows:

- Form 1003 (7/05 (rev. 6/09)): Rental (Property Disposition field)
- Form 1003 (1/2021): Retained (Status field) and Investment (Intended Occupancy field)

Net rental income to be earned on the property may also be entered and used to qualify in accordance with the above requirements.

## Entering Rental Income for the Subject Property in DU

The following rental income policies apply to properties that are the subject property. Refer to B3-3.1-08, Rental Income (06/03/2020) to determine the maximum amount of rental income that can be used for qualifying purposes for the subject property.

### Form 1003 7/05 (rev. 6/09)

"Subject net cash flow" for DU loan casefiles applies to rental income on the subject property. DU does not calculate the subject net cash flow. The lender must calculate and enter the income in Subject Net Cash in Section V of the online loan application.

**Investment property:** Calculate the net cash flow using the PITIA. If it is positive, it will be added to qualifying income. If it is negative, enter a negative value. DU treats the loss as a liability and includes it in the debt-to-income ratio. If income from the subject property is not used for qualifying purposes, the lender should enter the entire proposed PITIA as a negative amount.

**Two- to four-unit principal residence:** Calculate the net cash flow without subtracting the proposed PITIA. Net cash flow will be added to qualifying income. The PITIA will be included in the debt-to-income ratio.

### Form 1003 1/2021

Rental income for the subject property must be entered as follows:

- **For a property already owned by the borrower:** The borrower enters the property in Section 3 and the lender must calculate and enter the Net Monthly Rental Income.
- **For a property the borrower is purchasing:** The borrower enters Expected Monthly Rental Income in Section 4b. and the lender must calculate and enter the Expected Net Monthly Rental Income.

If income from an investment property is not included in the qualifying ratios, the lender must enter the entire proposed PITIA as a negative amount in Section 3 or 4b as applicable.

**Note:** Rental income from a one-unit principal residence with an accessory unit or from a two- to four-unit principal residence is an acceptable source of qualifying income on HomeReady loans.

## Documentation of Rental Income

Refer to B3-3.1-08, Rental Income (06/03/2020) for the applicable documentation requirements. If the debt-to-income ratio includes the entire rental property payment and income from the property is not used in qualifying, rental income documentation is not required. However, documentation of gross monthly rent for the subject property is required for lender reporting purposes. See A3-4-02, Data Quality and Integrity (08/07/2018), (Reporting of Gross Monthly Rent), for additional information.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-10	September 27, 2011
Announcement SEL-2011-03	March 31, 2011

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Asset Assessment

## Asset Assessment

### Introduction

This chapter explains asset assessment for qualifying, underwriting, and documentation purposes.

REVISION HISTORY 08/07/2019

REVISION NUMBER: 08072019 DATE: 08/07/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-4.1-01, Minimum Reserve Requirements (08/07/2019)

### Introduction

This topic contains information on minimum reserve requirements, including:

- What Are Liquid Financial Reserves?
- Acceptable Sources of Reserves
- Unacceptable Sources of Reserves
- Supplementing Borrower Funds
- Determining Required Minimum Reserves
- Calculation of Reserves for Multiple Financed Properties
- Simultaneous Second Home or Investment Property Transactions
- Examples of Reserves Calculations
- Additional Resources

### What Are Liquid Financial Reserves?

Liquid financial reserves are those liquid or near liquid assets that are available to a borrower after the mortgage closes. Liquid financial reserves include cash and other assets that are easily converted to cash by the borrower by

- drafting or withdrawing funds from an account,
- selling an asset,
- redeeming vested funds, or
- obtaining a loan secured by assets from a fund administrator or an insurance company.

Reserves are measured by the number of months of the qualifying payment amount for the subject mortgage (based on PITIA) that a borrower could pay using his or her financial assets. For monthly housing expense and qualifying payment requirements, see B3-6-03, Monthly Housing Expense for the Subject Property (04/01/2020) and B3-6-04, Qualifying Payment Requirements (04/15/2014).

The definition of reserves applies to both manually underwritten mortgage loans and loan casefiles underwritten through DU. Funds to close are subtracted from available assets when considering sufficient assets for reserves.

### Acceptable Sources of Reserves

Examples of liquid financial assets that can be used for reserves include readily available funds in

- checking or savings accounts;
- investments in stocks, bonds, mutual funds, certificates of deposit, money market funds, and trust accounts;
- the amount vested in a retirement savings account; and
- the cash value of a vested life insurance policy.

### Unacceptable Sources of Reserves

The following cannot be counted as part of the borrower's reserves:

- funds that have not been vested;
- funds that cannot be withdrawn under circumstances other than the account owner's retirement, employment termination, or death;
- stock held in an unlisted corporation;
- non-vested stock options and non-vested restricted stock;
- personal unsecured loans;
- interested party contributions (IPCs) (see B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019));
- any amount of a lender contribution (see B3-4.3-06, Donations From Entities (05/01/2018)); and
- cash proceeds from a cash-out refinance transaction on the subject property.

### Supplementing Borrower Funds

Funds received from acceptable sources may be used to supplement the borrower's funds to satisfy any financial reserve requirement.

### Determining Required Minimum Reserves

Minimum required reserves vary depending on

- the transaction,
- the occupancy status and amortization type of the subject property,
- the number of units in the subject property, and
- the number of other financed properties the borrower currently owns.

**Manually underwritten loans** : The minimum required reserves are documented in the *Eligibility Matrix*. However, when a borrower has multiple financed properties and is financing a second home or investment property, the lender must apply the applicable additional reserve requirements for the other financed second home and investment property transactions. Refer to the Calculation of Reserves for Multiple Financed Properties below for additional details.

**DU loan casefiles** : DU will determine the reserve requirements based on the overall risk assessment of the loan, the minimum reserve

requirement that may be required for the transaction, and whether the borrower has multiple financed properties.

If a borrower has multiple financed properties and is financing a second home or investment property, DU will base the reserve calculations for the other financed properties on the number of financed properties determined by DU. Refer to the Calculation of Reserves for Multiple Financed Properties below for additional details.

**Note:** High LTV refinance loans are exempt from the minimum reserve requirements.

**Calculation of Reserves for Multiple Financed Properties**

If the borrower owns other financed properties (determined in accordance with B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019)), additional reserves must be calculated and documented for financed properties other than the subject property and the borrower’s principal residence. The other financed properties reserves amount must be determined by applying a specific percentage to the aggregate of the outstanding unpaid principal balance (UPB) for mortgages and HELOCs on these other financed properties. The percentages are based on the number of financed properties:

- 2% of the aggregate UPB if the borrower has one to four financed properties,
- 4% of the aggregate UPB if the borrower has five to six financed properties, or
- 6% of the aggregate UPB if the borrower has seven to ten financed properties (DU only).

The aggregate UPB calculation does not include the mortgages and HELOCs that are on

- the subject property,
- the borrower’s principal residence,
- properties that are sold or pending sale, and
- accounts that will be paid by closing (or omitted in DU on the online loan application).

**Simultaneous Second Home or Investment Property Transactions**

If a lender is processing multiple second home or investment property applications simultaneously, the same assets may be used to satisfy the reserve requirements for both mortgage applications. Reserves are not cumulative for multiple applications.

Example: A lender is simultaneously processing two refinance applications for two investment properties owned by the borrower. The application for property A requires reserves of \$5,000. The application for property B requires reserves of \$10,000. Because the reserves are covering the same properties, the lender does not have to verify \$15,000 in reserves, but only those required per each application.

**Examples of Reserves Calculations**

The following tables contain examples of reserves calculations for borrowers with multiple financed properties.

**Example 1: Three Financed Properties**

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Second Home	\$78,750	\$776	2 Months PITIA =	\$1,552
Principal	\$0	\$179	N/A	\$0
Investor	\$87,550	\$787	\$230,050 x 2% =	\$4,601
Investor	\$142,500	\$905		
	<b>\$230,050</b>		<b>Total =</b>	<b>\$6,153</b>

**Example 2: Six Financed Properties**

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Investor	\$78,750	\$776	6 Months PITIA =	\$4,656
Principal	\$133,000	\$946	N/A	\$0
Investor	\$87,550	\$787	\$345,030 x 4% =	\$13,801
Investor	\$142,500	\$905		
Investor	\$84,950	\$722		
Investor	\$30,030	\$412		
	<b>\$345,030</b>		<b>Total =</b>	<b>\$18,457</b>

**Example 3: Eight Financed Properties (DU ONLY)**

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Investor	\$78,750	\$776	6 Months PITIA =	\$4,656
Principal	\$133,000	\$946	N/A	\$0
Investor	\$87,550	\$787	\$629,530 x 6% =	\$37,772
Investor	\$142,500	\$905		
Investor	\$84,950	\$722		
Investor	\$30,030	\$412		
Investor	\$124,500	\$837		
Second Home	\$124,500	\$837		

Investor	\$160,000	\$1,283		
	<b>\$629,530</b>		<b>Total =</b>	<b>\$42,427</b>

### Additional Resources

- B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019);
- B3-4.4-01, Asset Verification (04/03/2018);
- B3-6-03, Monthly Housing Expense for the Subject Property (04/01/2020); and
- B3-6-04, Qualifying Payment Requirements (04/15/2014).

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-03	April 03, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2017-07	August 29, 2017
Announcement SEL-2016-03	March 29, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2015-03	March 31, 2015
Announcement SEL-2015-02	February 24, 2015
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-06	April 30, 2010
Announcement -2009-19	June 8, 2009
Announcement -2009-02	February 6, 2009

### B3-4.1-01, Minimum Reserve Requirements (10/07/2020)

#### Introduction

This topic contains information on minimum reserve requirements, including:

- What Are Liquid Financial Reserves?
- Acceptable Sources of Reserves
- Unacceptable Sources of Reserves
- Supplementing Borrower Funds
- Determining Required Minimum Reserves
- Calculation of Reserves for Multiple Financed Properties
- Simultaneous Second Home or Investment Property Transactions
- Examples of Reserves Calculations
- Additional Resources

#### What Are Liquid Financial Reserves?

Liquid financial reserves are those liquid or near liquid assets that are available to a borrower after the mortgage closes. Liquid financial reserves include cash and other assets that are easily converted to cash by the borrower by

- drafting or withdrawing funds from an account,
- selling an asset,
- redeeming vested funds, or
- obtaining a loan secured by assets from a fund administrator or an insurance company.

Reserves are measured by the number of months of the qualifying payment amount for the subject mortgage (based on PITIA) that a borrower could pay using his or her financial assets. For monthly housing expense and qualifying payment requirements, see B3-6-03, Monthly Housing Expense for the Subject Property (12/16/2020) and B3-6-04, Qualifying Payment Requirements (04/15/2014).

The definition of reserves applies to both manually underwritten mortgage loans and loan casefiles underwritten through DU. Funds to close are subtracted from available assets when considering sufficient assets for reserves.

#### Acceptable Sources of Reserves

Examples of liquid financial assets that can be used for reserves include readily available funds in

- checking or savings accounts;

- investments in stocks, bonds, mutual funds, certificates of deposit, money market funds, and trust accounts;
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- the cash value of a vested life insurance policy.

### Unacceptable Sources of Reserves

The following cannot be counted as part of the borrower's reserves:

- funds that have not been vested;
- funds that cannot be withdrawn under circumstances other than the account owner's retirement, employment termination, or death;
- stock held in an unlisted corporation;
- non-vested stock options and non-vested restricted stock;
- personal unsecured loans;
- interested party contributions (IPCs) (see B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019));
- any amount of a lender contribution (see B3-4.3-06, Grants and Lender Contributions (12/16/2020)); and
- cash proceeds from a cash-out refinance transaction on the subject property.

### Supplementing Borrower Funds

Funds received from acceptable sources may be used to supplement the borrower's funds to satisfy any financial reserve requirement.

**Note:** Eligible gift funds (but not gifts of equity) may be used to satisfy reserve requirements.

### Determining Required Minimum Reserves

Minimum required reserves vary depending on

- the transaction,
- the occupancy status and amortization type of the subject property,
- the number of units in the subject property, and
- the number of other financed properties the borrower currently owns.

**Manually underwritten loans :** The minimum required reserves are documented in the *Eligibility Matrix*. However, when a borrower has multiple financed properties and is financing a second home or investment property, the lender must apply the applicable additional reserve requirements for the other financed second home and investment property transactions. Refer to the Calculation of Reserves for Multiple Financed Properties below for additional details.

**DU loan casefiles :** DU will determine the reserve requirements based on the overall risk assessment of the loan, the minimum reserve requirement that may be required for the transaction, and whether the borrower has multiple financed properties.

If a borrower has multiple financed properties and is financing a second home or investment property, DU will base the reserve calculations for the other financed properties on the number of financed properties determined by DU. Refer to the Calculation of Reserves for Multiple Financed Properties below for additional details.

**Note:** High LTV refinance loans are exempt from the minimum reserve requirements.

### Calculation of Reserves for Multiple Financed Properties

If the borrower owns other financed properties (determined in accordance with B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020)), additional reserves must be calculated and documented for financed properties other than the subject property and the borrower's principal residence. The other financed properties reserves amount must be determined by applying a specific percentage to the aggregate of the outstanding unpaid principal balance (UPB) for mortgages and HELOCs on these other financed properties. The percentages are based on the number of financed properties:

- 2% of the aggregate UPB if the borrower has one to four financed properties,
- 4% of the aggregate UPB if the borrower has five to six financed properties, or
- 6% of the aggregate UPB if the borrower has seven to ten financed properties (DU only).

The aggregate UPB calculation does not include the mortgages and HELOCs that are on

- the subject property,
- the borrower's principal residence,
- properties that are sold or pending sale, and
- accounts that will be paid by closing (or omitted in DU on the online loan application).

### Simultaneous Second Home or Investment Property Transactions

If a lender is processing multiple second home or investment property applications simultaneously, the same assets may be used to satisfy the reserve requirements for both mortgage applications. Reserves are not cumulative for multiple applications.

Example: A lender is simultaneously processing two refinance applications for two investment properties owned by the borrower. The application for property A requires reserves of \$5,000. The application for property B requires reserves of \$10,000. Because the reserves are covering the same properties, the lender does not have to verify \$15,000 in reserves, but only those required per each application.

### Examples of Reserves Calculations

The following tables contain examples of reserves calculations for borrowers with multiple financed properties.

#### Example 1: Three Financed Properties

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Second Home	\$78,750	\$776	2 Months PITIA =	\$1,552
Principal	\$0	\$179	N/A	\$0

Investor	\$87,550	\$787	\$230,050 x 2% =	\$4,601
Investor	\$142,500	\$905		
	<b>\$230,050</b>		<b>Total =</b>	<b>\$6,153</b>

**Example 2: Six Financed Properties**

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations	
Subject: Investor	\$78,750	\$776	6 Months PITIA =	\$4,656
Principal	\$133,000	\$946	N/A	\$0
Investor	\$87,550	\$787	\$345,030 x 4% =	\$13,801
Investor	\$142,500	\$905		
Investor	\$84,950	\$722		
Investor	\$30,030	\$412		
	<b>\$345,030</b>			

**Example 3: Eight Financed Properties (DU ONLY)**

Occupancy	Outstanding UPB	Monthly PITIA	Reserves Calculations			
Subject: Investor	\$78,750	\$776	6 Months PITIA =	\$4,656		
Principal	\$133,000	\$946	N/A	\$0		
Investor	\$87,550	\$787	\$629,530 x 6% =	\$37,772		
Investor	\$142,500	\$905				
Investor	\$84,950	\$722				
Investor	\$30,030	\$412				
Second Home	\$124,500	\$837				
Investor	\$160,000	\$1,283				
	<b>\$629,530</b>				<b>Total =</b>	<b>\$42,427</b>

**Additional Resources**

- B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020);
- B3-4.4-01, DU Asset Verification (12/16/2020);
- B3-6-03, Monthly Housing Expense for the Subject Property (12/16/2020); and
- B3-6-04, Qualifying Payment Requirements (04/15/2014).

**Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-06	October 07, 2020
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-03	April 03, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2017-07	August 29, 2017
Announcement SEL-2016-03	March 29, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2015-03	March 31, 2015
Announcement SEL-2015-02	February 24, 2015
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-06	April 30, 2010
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.1, General Asset Requirements > B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019)

### B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019)

#### Introduction

This topic contains information on interested party contributions, including:

- Overview
- IPC Limits
- Lender Checklist for IPCs
- Lender Incentives for Borrowers

#### Overview

Interested party contributions (IPCs) are costs that are normally the responsibility of the property purchaser that are paid directly or indirectly by someone else who has a financial interest in, or can influence the terms and the sale or transfer of, the subject property.

Interested parties to a transaction include, but are not limited to, the property seller, the builder/developer, the real estate agent or broker, or an affiliate who may benefit from the sale of the property and/or the sale of the property at the highest price possible. A lender or employer is not considered an interested party to a sales transaction unless it is the property seller or is affiliated with the property seller or another interested party to the transaction. (For Fannie Mae's purposes, an affiliation exists when there is direct common ownership or control by the lender over the interested party or vice versa, or when there is direct common ownership or control by a third party over both the lender and the interested party. A typical ongoing business relationship — for example, the relationship between a builder and a lender that serves as its financial institution — does not constitute an affiliation.)

IPCs are either financing concessions or sales concessions. Fannie Mae considers the following to be IPCs:

- funds that are paid directly from the interested party to the borrower;
- funds that flow from an interested party through a third-party organization, including nonprofit entities, to the borrower;
- funds that flow to the transaction on the borrower's behalf from an interested party, including a third-party organization or nonprofit agency; and
- funds that are donated to a third party, which then provides the money to pay some or all of the closing costs for a specific transaction.

A lender credit derived from premium pricing is not considered an IPC even if the lender is an interested party to the transaction.

See B3-4.1-03, Types of Interested Party Contributions (IPCs) (12/16/2020), for more information.

Fannie Mae does not permit IPCs to be used to make the borrower's down payment, meet financial reserve requirements, or meet minimum borrower contribution requirements.

#### IPC Limits

The table below provides IPC limits for conventional mortgages.

IPCs that exceed these limits are considered sales concessions. The property's sales price must be adjusted downward to reflect the amount of contribution that exceeds the maximum, and the maximum LTV/CLTV ratios must be recalculated using the reduced sales price or appraised value.

Occupancy Type	LTV/CLTV Ratio	Maximum IPC
Principal residence or second home	Greater than 90%	3% <sup>1</sup>
	75.01% – 90%	6%
	75% or less	9%
Investment property	All CLTV ratios	2%

<sup>1</sup> See B5-4.2-03, Loans Secured by HomePath Properties (05/31/2016) for an exception to this limit for principal residence transactions.

#### Lender Checklist for IPCs

The lender must ensure that all of the following requirements for an IPC are satisfied.

✓	Lender Checklist for IPCs
	Ensure that any and all IPCs have been identified and taken into consideration.
	Provide the appraiser with all appropriate financing data and IPCs for the subject property granted by anyone associated with the transaction.
	Ensure that the property value is adequately supported.
	Ensure that the LTV and CLTV ratios, after any IPCs are taken into consideration, remain within Fannie Mae's eligibility limits for the particular product.
	Ensure that mortgage insurance coverage, if applicable, has been obtained, based on the LTV ratio after any IPC adjustments have been made.
	Scrutinize all loan and sales contract documents, including but not limited to the sales contract, the loan estimate, the loan application, the appraisal report, and the settlement statement.
	Ensure that all elements of the settlement statement were taken into consideration during the underwriting process.

Ensure that fees and expenses are consistent between all documents. Analyze any differences and review any discrepancies.

## Lender Incentives for Borrowers

**Cash or Cash-like Incentives for all Transaction Types:** The lender may provide the borrower with a cash or cash-like (e.g., a gift card) incentive that is not reflected on the settlement statement provided that

- the amount of the incentive does not exceed \$500, and
- no repayment is required.

Because the lender is not typically a party to the sales transaction, these types of lender incentives are not considered IPCs and, as a result, are not included in the IPC limit calculation. Furthermore, these incentives are not considered cash out to the borrower and do not have to be included in the cash back to borrower at closing calculation.

**Note:** Documentation of compliance with this policy will not be required at the loan level. However, the lender must establish policies and/or procedures to ensure that the loans with these types of incentives that it delivers to Fannie Mae, whether or not the loans were originated by the lender, are in compliance with this policy.

**Pay Down of Existing Mortgage Balance for Eligible Refinance Transactions:** For refinance transactions, incentives to the borrower in the form of a payment to pay off a portion of the mortgage loan being refinanced is not considered an IPC and, as a result, is not included in the IPC limit calculation. Furthermore, this incentive is not considered cash out to the borrower and it does not have to be included in the cash back to borrower at closing calculation.

See *New Loan Requirements* in B5-7-01, High LTV Refinance Loan and Borrower Eligibility (08/07/2018) for exceptions associated with high LTV refinance loans.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-06	August 07, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2016-05	June 28, 2016
Announcement SEL-2014-07	June 24, 2014
Announcement SEL-2013-03	April 9, 2013
Announcement SEL-2010-06	April 30, 2010
Announcement -2009-37	December 30, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.1, General Asset Requirements > B3-4.1-03, Types of Interested Party Contributions (IPCs) (12/16/2020)

REVISION HISTORY 03/29/2016

REVISION NUMBER: 03292016 DATE: 03/29/2016

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-4.1-03, Types of Interested Party Contributions (IPCs) (03/29/2016)

### Introduction

This topic contains information on types of interested party contributions, including:

- Undisclosed IPCs
- Down Payment Assistance Programs
- Financing Concessions
- Sales Concessions
- Interest Rate Buydowns
- Payment Abatements

### Undisclosed IPCs

Mortgages with undisclosed IPCs are not eligible for delivery to Fannie Mae. Examples of these types of contributions include, but are not limited to, moving expenses, payment of various fees on the borrower's behalf, "silent" second mortgages held by the property seller, and other contributions that are given to the borrower outside of closing and are not disclosed on the settlement statement.

### Down Payment Assistance Programs

Funds that are donated to third parties which are then applied toward some or all of the borrower's closing costs for a specific transaction are sometimes referred to as Down Payment Assistance Programs (DAPs). As long as the DAP allows such uses, these funds may also be used to pay for energy-related improvements that meet the requirements described in B5-3.3-01, HomeStyle Energy for Improvements on Existing Properties (06/03/2020).

IPC funds that flow through a DAP may be used for allowable closing costs, prepaids, and energy-related expenses in compliance with Fannie Mae's IPC limits.

### Financing Concessions

Financing concessions that are paid on the borrower's behalf are subject to Fannie Mae's IPC limits. Financing concessions are:

- financial contributions from interested parties that provide a benefit to the borrower in the financing transaction;
- payments or credits related to acquiring the property; and
- payments or credits for financing terms, including prepaids.

Typical fees and/or closing costs paid by a seller in accordance with local custom, known as common and customary fees or costs, are not subject to Fannie Mae IPC limits. Payoff of a PACE loan by a seller is not subject to Fannie Mae IPC limits because it is not a financing concession. Financing concessions that exceed the limits listed below are considered sales concessions and are subject to Fannie Mae IPC limits.

Financing concessions typically include origination fees, discount points, commitment fees, appraisal costs, transfer taxes, stamps, attorneys' fees, survey charges, title insurance premiums or charges, real estate tax service fees, and funds to subsidize a temporary or permanent interest rate buydown (if these fees are not considered common and customary fees or costs based on local custom, as described above). Financing concessions can also include prepaid items, such as:

- interest charges (limited to no more than 30 days of interest);
- real estate taxes covering any period after the settlement date (only if the taxes are being impounded by the servicer for future payment);
- property insurance premiums (limited to no more than 14 months);
- homeowners' association (HOA) assessments covering any period after the settlement date (limited to no more than 12 months);
- initial and/or renewal mortgage insurance premiums; and
- escrow accruals required for renewal of borrower-purchased mortgage insurance coverage.

### Sales Concessions

Sales concessions are IPCs that take the form of non-realty items. They include cash, furniture, automobiles, decorator allowances, moving costs, and other giveaways, as well as financing concessions that exceed Fannie Mae limits. Consequently, the value of sales concessions must be deducted from the sales price when calculating LTV and combined LTV ratios for underwriting and eligibility purposes.

### Interest Rate Buydowns

If a temporary or permanent interest rate buydown is being offered to the borrower, the cost of the subsidy to fund that buydown must be included in the IPC calculation, if received from an interested party or a lender affiliated with an interested party.

The lender must determine if the cost of the subsidy meets allowable IPC limits. This can be accomplished by confirming the current market interest rate—in other words, the rate that is offered without the payment of any discount points—and the discount points being charged to obtain the interest rate being offered with the buydown.

**Note:** Fees for standby commitments that a builder obtains for blanket coverage before it enters into a contract with a borrower are not subject to Fannie Mae's IPC limits because they are not attributable to the specific mortgage transaction.

### Payment Abatements

A payment abatement is considered to be a financing concession since it is an incentive provided to the borrower by an interested party, in which the interested party provides funds to pay or reimburse a certain number of monthly payments on the borrower's behalf. The monthly payments may cover, in whole or in part, principal, interest, taxes, insurance and other assessments (PITIA). These funds are provided to the lender or a third party to be distributed over the term of the abatement period or credited against the borrower's future obligations.

Loans with payment abatements of any type are not eligible for delivery to Fannie Mae regardless of whether they are disclosed on the settlement statement. This prohibition applies to transactions in which an interested party is directly funding the abatement and/or if the funding for the abatement is flowing through another entity such, as a nonprofit down payment assistance program.

**Note:** The payment of HOA fees is not considered an abatement unless the payment of the fee extends for more than 12 months. The payment of HOA fees for 12 months or less is considered an interested party contribution.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2016-03	March 29, 2016
Announcement SEL-2010-09	June 30, 2010
Announcement SEL-2010-07	May 27, 2010
Announcement -2009-32	October 30, 2009
Announcement -2009-02	February 6, 2009

### B3-4.1-03, Types of Interested Party Contributions (IPCs) (12/16/2020)

#### Introduction

This topic contains information on types of interested party contributions, including:

- Undisclosed IPCs
- Down Payment Assistance Programs
- Financing Concessions
- Sales Concessions
- Interest Rate Buydowns
- Payment Abatements

## Undisclosed IPCs

Mortgages with undisclosed IPCs are not eligible for delivery to Fannie Mae. Examples of these types of contributions include, but are not limited to, moving expenses, payment of various fees on the borrower's behalf, "silent" second mortgages held by the property seller, and other contributions that are given to the borrower outside of closing and are not disclosed on the settlement statement.

## Down Payment Assistance Programs

Funds that are donated to third parties which are then applied toward some or all of the borrower's closing costs for a specific transaction are sometimes referred to as Down Payment Assistance Programs (DAPs). As long as the DAP allows such uses, these funds may also be used to pay for energy-related improvements that meet the requirements described in B5-3.3-01, HomeStyle Energy for Improvements on Existing Properties (12/16/2020).

IPC funds that flow through a DAP may be used for allowable closing costs, prepaids, and energy-related expenses in compliance with Fannie Mae's IPC limits.

## Financing Concessions

Financing concessions that are paid on the borrower's behalf are subject to Fannie Mae's IPC limits. Financing concessions are:

- financial contributions from interested parties that provide a benefit to the borrower in the financing transaction;
- payments or credits related to acquiring the property; and
- payments or credits for financing terms, including prepaids.

Typical fees and/or closing costs paid by a seller in accordance with local custom, known as common and customary fees or costs, are not subject to Fannie Mae IPC limits. Payoff of a PACE loan by a seller is not subject to Fannie Mae IPC limits because it is not a financing concession. Financing concessions that exceed the limits listed below are considered sales concessions and are subject to Fannie Mae IPC limits.

Financing concessions typically include origination fees, discount points, commitment fees, appraisal costs, transfer taxes, stamps, attorneys' fees, survey charges, title insurance premiums or charges, real estate tax service fees, and funds to subsidize a temporary or permanent interest rate buydown (if these fees are not considered common and customary fees or costs based on local custom, as described above). Financing concessions can also include prepaid items, such as:

- interest charges (limited to no more than 30 days of interest);
- real estate taxes covering any period after the settlement date (only if the taxes are being impounded by the servicer for future payment);
- property insurance premiums (limited to no more than 14 months);
- homeowners' association (HOA) assessments covering any period after the settlement date (limited to no more than 12 months);
- initial and/or renewal mortgage insurance premiums; and
- escrow accruals required for renewal of borrower-purchased mortgage insurance coverage.

A legitimate pro-rated real estate tax credit in places where real estate taxes are paid in arrears is not considered a financing concession and is not subject to Fannie Mae IPC limits.

## Sales Concessions

Sales concessions are IPCs that take the form of non-realty items. They include cash, furniture, automobiles, decorator allowances, moving costs, and other giveaways, as well as financing concessions that exceed Fannie Mae limits. Consequently, the value of sales concessions must be deducted from the sales price when calculating LTV and combined LTV ratios for underwriting and eligibility purposes.

## Interest Rate Buydowns

If a temporary or permanent interest rate buydown is being offered to the borrower, the cost of the subsidy to fund that buydown must be included in the IPC calculation, if received from an interested party or a lender affiliated with an interested party.

The lender must determine if the cost of the subsidy meets allowable IPC limits. This can be accomplished by confirming the current market interest rate—in other words, the rate that is offered without the payment of any discount points—and the discount points being charged to obtain the interest rate being offered with the buydown.

**Note:** Fees for standby commitments that a builder obtains for blanket coverage before it enters into a contract with a borrower are not subject to Fannie Mae's IPC limits because they are not attributable to the specific mortgage transaction.

## Payment Abatements

A payment abatement is considered to be a financing concession since it is an incentive provided to the borrower by an interested party, in which the interested party provides funds to pay or reimburse a certain number of monthly payments on the borrower's behalf. The monthly payments may cover, in whole or in part, principal, interest, taxes, insurance and other assessments (PITIA). These funds are provided to the lender or a third party to be distributed over the term of the abatement period or credited against the borrower's future obligations.

Loans with payment abatements of any type are not eligible for delivery to Fannie Mae regardless of whether they are disclosed on the settlement statement. This prohibition applies to transactions in which an interested party is directly funding the abatement and/or if the funding for the abatement is flowing through another entity such as a nonprofit down payment assistance program.

**Note:** The payment of HOA fees is not considered an abatement unless the payment of the fee extends for more than 12 months. The payment of HOA fees for 12 months or less is considered an interested party contribution.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2016-03	March 29, 2016

Announcement SEL-2010-09	June 30, 2010
Announcement SEL-2010-07	May 27, 2010
Announcement -2009-32	October 30, 2009
Announcement -2009-02	February 6, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.2, Verification of Depository Assets > B3-4.2-01, Verification of Deposits and Assets (04/25/2017)

### **B3-4.2-01, Verification of Deposits and Assets (04/25/2017)**

#### **Introduction**

This topic contains information on verifying deposits and assets, including:

- Verification of Deposits and Assets
- Blanket Authorization Form

#### **Verification of Deposits and Assets**

The lender can use any of the following types of documentation to verify that a borrower has sufficient funds for closing, down payment, and/or financial reserves:

- *Request for Verification of Deposit* (Form 1006 or Form 1006(S)). The information must be requested directly from the depository institution, and the complete, signed, and dated document must be sent directly from the depository institution.
- Copies of bank statements or investment portfolio statements. The statements must cover the most recent full two-month period of account activity (60 days, or, if account information is reported on a quarterly basis, the most recent quarter). The statements must:
  - clearly identify the borrower as the account holder,
  - include at least the last four digits of 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.

If the lender is the holder of the borrower's account, the lender may produce a printout or other alternative verification of the asset(s) directly from its system. The printout or alternative verification is acceptable as long as all required data (above) is supplied and documented.

- Direct verification by a third-party asset verification vendor. These verifications are acceptable as long as:
  - the borrower provided proper authorizations for the lender to use the verification method,
  - the verified information provided must conform with the information that would be provided on Form 1006, Form 1006(S), or on bank statements,
  - the date of the completed verification is in compliance with B1-1-03, Allowable Age of Credit Documents and Federal Income Tax Returns (12/16/2020),
  - the lender has determined that the vendor maintains reasonable practices that ensure reliable and authorized verifications of deposit and asset information (see A4-1-01, Maintaining Seller/Service Eligibility (12/16/2020)), and
  - the lender understands it will be held accountable for the integrity of the information obtained from this source.
- Copies of retirement account statements. They must be the most recent statements, and they must identify the borrower's vested amount and the terms. (See B3-4.3-03, Retirement Accounts (06/30/2015), for additional information.)

If the latest bank statement is more than 45 days earlier than the date of the loan application, the lender should ask the borrower to provide a more recent, supplemental, bank-generated form that shows at least the last four digits of the account number, balance, and date. The statements may be computer-generated forms, including online account or portfolio statements downloaded by the borrower from the Internet.

Documents that are faxed to the lender or downloaded from the Internet must clearly identify the name of the depository or investment institution and the source of information—for example, by including that information in the Internet or fax banner at the top of the document.

If necessary, the lender must supplement these verifications by obtaining any missing information from the borrower or the depository institution.

Loans with assets validated by DU must comply with all requirements pertaining to the DU validation service. Compliance with the DU messages satisfies the requirement for documenting assets. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020), for additional information.

#### **Blanket Authorization Form**

Rather than having the applicant sign multiple forms, the lender may have the applicant sign an authorization form which gives the lender blanket authorization to request the information it needs to evaluate the applicant's creditworthiness. (See B1-1-02, Blanket Authorization Form (04/01/2009).) When the lender uses this type of blanket authorization, it must attach a copy of the authorization form to each Form 1006 or Form 1006(S) it sends to the depository institutions in which the applicant has accounts.

#### **Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

<b>Announcements</b>	<b>Issue Date</b>
Announcement SEL-2017-04	April 25, 2017
Announcement SEL-2016-09	December 6, 2016

Announcement SEL-2015-06	May 26, 2015
Announcement SEL-2014-12	September 30, 2014
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2011-04	May 24, 2011

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.2, Verification of Depository Assets > B3-4.2-02, Depository Accounts (12/06/2016)

### B3-4.2-02, Depository Accounts (12/06/2016)

#### Introduction

This topic contains information on depository accounts, including:

- Depository Accounts
- Business Assets
- Evaluating Large Deposits
- Request for Verification of Deposit

#### Depository Accounts

Funds held in a checking, savings, money market, certificate of deposit, or other depository accounts may be used for the down payment, closing costs, and financial reserves. The funds must be verified as described in B3-4.2-01, Verification of Deposits and Assets (04/25/2017). Unverified funds are not acceptable for the down payment, closing costs, or financial reserves.

The lender must investigate any indications of borrowed funds. These must be identified differently based upon how the asset account was verified.

#### Business Assets

Business assets may be an acceptable source of funds for the down payment, closing costs, and financial reserves when a borrower is self-employed and the individual federal income tax returns have been evaluated by the lender, including, if applicable, the business federal income tax returns for that particular business (non-Schedule C). The borrower must be listed as an owner of the account and the account must be verified in accordance with B3-4.2-01, Verification of Deposits and Assets (04/25/2017). The lender must perform a business cash flow analysis to confirm that the withdrawal of funds for this transaction will not have a negative impact on the business. See Section B3-3.2, Self-Employment Income, for additional information on the analysis of a self-employed borrower.

#### Evaluating Large Deposits

When bank statements (typically covering the most recent two months) are used, the 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 in the table below.

Transaction Type	Evaluation Requirements
Refinance transactions	Documentation or explanation for large deposits is <b>not</b> required; however, the lender remains responsible for ensuring that any borrowed funds, including any related liability, are considered.
Purchase transactions	<ul style="list-style-type: none"> <li>• 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), the lender must document that those funds are from an acceptable source. Occasionally, a borrower may not have all of the documentation required to confirm the source of a deposit. In those instances, the 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. Examples of acceptable documentation include the borrower's written explanation, proof of ownership of an asset that was sold, or a copy of a wedding invitation to support receipt of gift funds. The lender must place in the loan file written documentation of the rationale for using the funds.</li> <li>• Verified funds must be reduced by the amount (or portion) of the undocumented large deposit (as defined above), and the lender must confirm that the remaining funds are sufficient for the down payment, closing costs, and financial reserves. When the lender uses a reduced asset amount, net of the unsourced amount of a large deposit, that reduced amount must be used for underwriting purposes (whether the mortgage loan is underwritten manually or through DU). <b>Note:</b> When a deposit has both sourced and unsourced portions, only the unsourced portion must be used to calculate whether or not it must be considered a large deposit.</li> </ul> <p><b>Examples</b></p> <ul style="list-style-type: none"> <li>• <b>Scenario 1:</b> Borrower has monthly income of \$4,000 and an account at ABC Bank with a balance of \$20,000. A deposit of \$3,000 is identified, but \$2,500 of that deposit is documented as coming from the borrower's federal income tax refund. Only the unsourced \$500 [the deposit of \$3,000 minus the documented \$2,500] must be considered in calculating whether it meets the large deposit definition. The unsourced \$500 is 12.5% of the borrower's \$4,000 monthly income, falling short of the 50% definition of a large deposit. Therefore, it is not considered a large deposit and the entire \$20,000 balance in the ABC Bank account can be used for underwriting purposes.</li> <li>• <b>Scenario 2:</b> Using the same borrower example, a deposit of \$3,000 is identified, but only \$500 is documented as coming from the borrower's federal income tax refund, leaving \$2,500 unsourced.</li> </ul>

In this instance, the unsecured \$2,500 is 63% of the borrower's \$4,000 monthly income, which does meet the definition of a large deposit.

Therefore, the unsecured \$2,500 must be subtracted from the account balance of \$20,000 and only the remaining \$17,500 may be used for underwriting purposes.

**Note:** If the source of a large deposit is readily identifiable on the account statement(s), such as a direct deposit from an employer (payroll), the Social Security Administration, or IRS or state income tax refund, or a transfer of funds between verified accounts, and the source of the deposit is printed on the statement, the lender does not need to obtain further explanation or documentation. However, if the source of the deposit is printed on the statement, but the lender still has questions as to whether the funds may have been borrowed, the lender should obtain additional documentation.

The DU validation service automates the assessment of large deposits. When assets are validated, DU issues a message indicating which large deposits require documentation. Compliance with the DU messages satisfies the requirement for documenting large deposits. See B3-2-02, DU Validation Service (10/07/2020)

### Request for Verification of Deposit

When a *Verification of Deposit* (Form 1006 or Form 1006(S)) (VOD) is used and depository activity is not included, the lender must verify the source of funds for

- accounts opened within the last 90 days of the application date, and
- account balances that are considerably greater than the average balance reflected on the VOD.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2016-09	December 6, 2016
Announcement SEL-2014-06	May 27, 2014
Announcement SEL-2012-13	November 13, 2012

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.2, Verification of Depository Assets > B3-4.2-03, Individual Development Accounts (02/06/2019)

### B3-4.2-03, Individual Development Accounts (02/06/2019)

#### Introduction

This topic contains information on individual development accounts, including:

- Individual Development Accounts
- Use of IDA Funds to Meet Borrower Minimum Contribution Requirements
- Lender Checklist for IDAs

#### Individual Development Accounts

Some nonprofit agencies will match the funds a borrower regularly deposits into a savings account that has been designated as an account that is used solely for the accumulation of funds to purchase a home. Such accounts are referred to as individual development accounts, or IDAs.

Nonprofit agencies that offer IDA programs have options with respect to accumulating and holding the matching funds, which include:

- the use of a parallel "savings" account that is separate from the home buyer's savings account;
- separately designated matching funds within a single agency account via accounting processes to allocate matching funds to a particular home buyer; and
- the use of a trustee account that contains both the home buyer's funds and the agency's matching funds.

When a home buyer reaches the target amount and is ready to complete the home purchase, the funds are disbursed from the nonprofit agency account to the closing agent via a single check or multiple checks.

If the agency's matching funds are held in an account that is separate from the home buyer's account, the matching funds need not be commingled with the home buyer's funds prior to disbursement to the closing agent. It is acceptable to allow the separate disbursement of funds from the agency and from the home buyer, as long as the terms of the IDA program are met.

Funds that the borrower deposited into an IDA may be used for either closing costs or the down payment.

#### Use of IDA Funds to Meet Borrower Minimum Contribution Requirements

Funds that the borrower deposited into an IDA may be used for either the closing costs or the down payment. Depending on the repayment terms of the IDA program, the borrower may or may not be required to meet the minimum down payment requirements from his or her own funds, as outlined below:

IDA Repayment Terms	Allowable Use of Matching Funds
The nonprofit agency <ul style="list-style-type: none"><li>• requires repayment of the matching funds,</li></ul>	The borrower may use the matching funds to supplement the down payment provided he or she has met the minimum borrower contribution requirements.

<ul style="list-style-type: none"> <li>• agrees to defer or forgive repayment provided that certain conditions are met, or</li> <li>• files a lien against the property.</li> </ul>	<p>The minimum borrower contribution must come from the borrower's own funds unless:</p> <ul style="list-style-type: none"> <li>• the LTV or CLTV ratio is less than or equal to 80%; or</li> <li>• the borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower's minimum contributions. See B3-4.3-04, Personal Gifts (10/07/2020); B3-4.3-06, Grants and Lender Contributions (12/16/2020); and B3-4.3-08, Employer Assistance (09/29/2015), for additional information.</li> </ul>
<p>The nonprofit agency</p> <ul style="list-style-type: none"> <li>• does not require repayment of the matching funds and</li> <li>• does not file a lien against the property.</li> </ul>	<p>The borrower may use the matching funds for some or all of the down payment without first being required to meet the minimum borrower contribution requirement from his or her own funds.</p>

### Lender Checklist for IDAs

The lender must ensure that all of the following requirements for an IDA are satisfied:

✓	Lender Checklist for IDAs
	Document how the nonprofit agency's IDA program operates.
	Verify the rate at which the agency matches borrower deposits into the account.
	Determine that the borrower satisfied the program's vesting requirements.
	Document the borrower's regular payments into the account and the agency's regular deposits of matching funds into the account.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-01	February 06, 2019
Announcement SEL-2010-16	December 1, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.2, Verification of Depository Assets > B3-4.2-04, Pooled Savings (Community Savings Funds) (04/01/2009)

#### B3-4.2-04, Pooled Savings (Community Savings Funds) (04/01/2009)

##### Introduction

This topic contains information on pooled savings (community savings funds).

##### Pooled Savings (Community Savings Funds)

Funds from a community savings account or any other type of pooled savings may be used for the down payment if the borrower can document regular contributions to the fund.

Acceptable documentation includes written confirmation from the party managing the pooled savings fund and documentation of regular borrower contributions.

The borrower's obligation to continue making contributions to the fund must be considered as part of the borrower's debt when calculating the total debt-to-income ratio.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.2, Verification of Depository Assets > B3-4.2-05, Verification of Assets for Non-U.S. Citizen Borrowers (04/01/2009)

#### B3-4.2-05, Verification of Assets for Non-U.S. Citizen Borrowers (04/01/2009)

##### Introduction

This topic contains information on the verification of assets for non-U.S. citizen borrowers.

##### Verification of Assets for Non-U.S. Citizen Borrowers

The lender must document all sources of funds used for down payments and closing costs.

Funds that a non-U.S. citizen 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 that the funds belonged to the borrower before the date of the transfer, and
- The sources of all funds used for closing can be verified just as they would for a borrower who is a U.S. citizen.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-01, Stocks, Stock Options, Bonds, and Mutual Funds (06/30/2015)

### B3-4.3-01, Stocks, Stock Options, Bonds, and Mutual Funds (06/30/2015)

#### Introduction

This topic contains information on stocks, stock options, bonds, and mutual funds.

#### Stocks, Stock Options, Bonds, and Mutual Funds

Vested assets in the form of stocks, government bonds, and mutual funds are acceptable sources of funds for the down payment, closing costs, and reserves provided their value can be verified. The lender must verify the borrower's ownership of the account or asset. The value of the asset and any related documentation must meet the requirements outlined in the table below.

Asset Type	Determining the Value of the Asset
Stocks and mutual funds	The lender must determine the value of the asset (net of any margin accounts) by obtaining either <ul style="list-style-type: none"><li>the most recent monthly or quarterly statement from the depository or investment firm; or</li><li>a copy of the stock certificate, accompanied by a newspaper stock list that is dated as of or near the date of the loan application.</li></ul>
Stock options	The value of vested stock options can be documented by <ul style="list-style-type: none"><li>a statement that lists the number of options and the option price, and</li><li>using the current stock price to determine the gain that would be realized from exercise of an option and the sale of the optioned stock.</li></ul> <p><b>Note:</b> Non-vested stock options are not an acceptable source of funds for the down payment, closing costs, or reserves and should not be entered on the loan application.</p>
Government bonds	The value of government bonds must be based on their purchase price unless the redemption value can be documented.

When used for the down payment or closing costs, if the value of the asset (as determined above) is at least 20% more than the amount of funds needed for the down payment and closing costs, no documentation of the borrower's actual receipt of funds realized from the sale or liquidation is required. Otherwise, evidence of the borrower's actual receipt of funds realized from the sale or liquidation must be documented.

When used for reserves, 100% of the value of the assets (as determined above) may be considered, and liquidation is not required.

Refer to B3-4.3-03, Retirement Accounts (06/30/2015), for the requirements pertaining to the use of retirement accounts for the down payment, closing costs, or reserves.

#### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2015-07	June 30, 2015
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-02, Trust Accounts (04/01/2009)

### B3-4.3-02, Trust Accounts (04/01/2009)

#### Introduction

This topic contains information on trust accounts.

#### Trust Accounts

Funds disbursed from a borrower's trust account are an acceptable source for the down payment, closing costs, and reserves provided the borrower has immediate access to the funds.

To document trust account funds, the lender must:

- obtain written documentation of the value of the trust account from either the trust manager or the trustee, and
- document 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.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-03, Retirement Accounts (06/30/2015)

### B3-4.3-03, Retirement Accounts (06/30/2015)

#### Introduction

This topic contains information on retirement accounts.

#### Retirement Accounts

Vested funds from individual retirement accounts (IRA/SEP/Keogh accounts) and tax-favored retirement savings accounts (401(k) accounts) are acceptable sources of funds for the down payment, closing costs, and reserves. The lender must verify the ownership of the account and confirm that the account is vested and allows withdrawals regardless of current employment status.

If the retirement assets are in the form of stocks, bonds, or mutual funds, the account must meet the requirements of B3-4.3-01, Stocks, Stock Options, Bonds, and Mutual Funds (06/30/2015), for determining value and whether documentation of the borrower's actual receipt of funds is required when used for the down payment and closing costs. When funds from retirement accounts are used for reserves, Fannie Mae does not require the funds to be withdrawn from the account(s).

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2011-04	May 24, 2011
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-04, Personal Gifts (10/07/2020)

### REVISION HISTORY 09/29/2015

REVISION NUMBER: 09292015 DATE: 09/29/2015

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-4.3-04, Personal Gifts (09/29/2015)

### Introduction

This topic contains information on personal gifts, including:

- Gift Funds
- Acceptable Donors
- Minimum Borrower Contribution Requirements
- Documentation Requirements
- Verifying Donor Availability of Funds and Transfer of Gift Funds

### Gift Funds

A borrower of a mortgage loan secured by a principal residence or second home may use funds received as a personal gift from an acceptable donor. Gift funds may fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements below. Gifts are not allowed on an investment property.

### Acceptable Donors

A gift can be provided by:

- 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.

The donor may not be, or have any affiliation with, the builder, the developer, the real estate agent, or any other interested party to the transaction.

### Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain gifts.

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
80% or less	One- to four-unit principal residence Second home	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.
	Two- to four-unit principal residence Second home	The borrower must make a 5% minimum borrower contribution from his or her own funds. <sup>1</sup> After the minimum borrower contribution has been met, gifts can be used to supplement the down payment, closing costs, and reserves.  See B5-6-03, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for HomeReady mortgage minimum borrower contribution and down payment requirements.

<sup>1</sup> If the borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, or from a fiancé or fiancée, the gift is considered the borrower's own funds and may be used to satisfy the minimum borrower contribution requirement as long as both individuals will use the home being

purchased as their principal residence.

### Documentation Requirements

Gifts must be evidenced by a letter signed by the donor, called a gift letter. The gift letter must:

- specify the dollar amount of the gift;
- specify the date the funds were transferred;
- include the donor's statement that no repayment is expected; and
- indicate the donor's name, address, telephone number, and relationship to the borrower.

When a gift from a relative or domestic partner is being pooled with the borrower's funds to make up the required minimum cash down payment, the following items must also be included:

- A certification from the donor stating that he or she has lived with the borrower for the past 12 months and will continue to do so in the new residence.
- Documents that demonstrate a history of borrower and donor shared residency. The donor's address must be the same as the borrower's address. Examples include but are not limited to a copy of a driver's license, a bill, or a bank statement.

### Verifying Donor Availability of Funds and Transfer of Gift Funds

The lender must verify that sufficient funds to cover the gift are either in the donor's account or have been transferred to the borrower's account. Acceptable documentation includes the following:

- a copy of the donor's check and the borrower's deposit slip,
- a copy of the donor's withdrawal slip and the borrower's deposit slip,
- a copy of the donor's check to the closing agent, or
- a settlement statement showing receipt of the donor's check.

When the funds are not transferred prior to settlement, the lender must document that the donor gave the closing agent the gift funds in the form of a certified check, a cashier's check, or other official check.

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement -2009-32	October 30, 2009

### B3-4.3-04, Personal Gifts (10/07/2020)

#### Introduction

This topic contains information on personal gifts, including:

- Gift Funds
- Acceptable Donors
- Minimum Borrower Contribution Requirements
- Documentation Requirements
- Verifying Donor Availability of Funds and Transfer of Gift Funds

#### Gift Funds

A borrower of a mortgage loan secured by a principal residence or second home may use funds received as a personal gift from an acceptable donor. Gift funds may fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements below. Gifts are not allowed on an investment property.

**Note:** A gift of equity may not be used for financial reserves. For additional information, see B3-4.3-05, Gifts of Equity (10/07/2020)

#### Acceptable Donors

A gift can be provided by:

- 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.

The donor may not be, or have any affiliation with, the builder, the developer, the real estate agent, or any other interested party to the transaction.

**Note:** The donor of a gift of equity is not considered an interested party to the transaction.

See B3-4.3-06, Grants and Lender Contributions (12/16/2020), for information about donations from entities (grants).

#### Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain gifts.

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
80% or less	One- to four-unit principal residence Second home	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a gift.
	Two- to four-unit principal residence Second home	The borrower must make a 5% minimum borrower contribution from his or her own funds. <sup>1</sup> After the minimum borrower contribution has been met, gifts can be used to supplement the down payment, closing costs, and reserves.  See B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for HomeReady mortgage minimum borrower contribution and down payment requirements.

<sup>1</sup> If the borrower receives a gift from a relative or domestic partner who has lived with the borrower for the last 12 months, or from a fiancé or fiancée, the gift is considered the borrower's own funds and may be used to satisfy the minimum borrower contribution requirement as long as both individuals will use the home being purchased as their principal residence.

### Documentation Requirements

Gifts must be evidenced by a letter signed by the donor, called a gift letter. The gift letter must:

- specify the dollar amount of the gift;
- specify the date the funds were transferred;
- include the donor's statement that no repayment is expected; and
- indicate the donor's name, address, telephone number, and relationship to the borrower.

When a gift from a relative or domestic partner is being pooled with the borrower's funds to make up the required minimum cash down payment, the following items must also be included:

- A certification from the donor stating that he or she has lived with the borrower for the past 12 months and will continue to do so in the new residence.
- Documents that demonstrate a history of borrower and donor shared residency. The donor's address must be the same as the borrower's address. Examples include but are not limited to a copy of a driver's license, a bill, or a bank statement.

### Verifying Donor Availability of Funds and Transfer of Gift Funds

The lender must verify that sufficient funds to cover the gift are either in the donor's account or have been transferred to the borrower's account. Acceptable documentation includes the following:

- a copy of the donor's check and the borrower's deposit slip,
- a copy of the donor's withdrawal slip and the borrower's deposit slip,
- a copy of the donor's check to the closing agent, or
- a settlement statement showing receipt of the donor's check.

When the funds are not transferred prior to settlement, the lender must document that the donor gave the closing agent the gift funds in the form of a certified check, a cashier's check, or other official check.

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2020-06	October 07, 2020
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement -2009-32	October 30, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-05, Gifts of Equity (10/07/2020)

### B3-4.3-05, Gifts of Equity (10/07/2020)

#### Introduction

This topic contains information on gifts of equity, including:

- Gift of Equity
- Documentation Requirements

### Gift of Equity

A “gift of equity” refers to a gift provided by the seller of a property to the buyer. The gift represents a portion of the seller’s equity in the property, and is transferred to the buyer as a credit in the transaction.

A gift of equity

- is permitted for principal residence and second home purchase transactions;
- can be used to fund all or part of the down payment and closing costs (including prepaid items); and
- cannot be used towards financial reserves.

The acceptable donor and minimum borrower contribution requirements for gifts also apply to gifts of equity. See B3-4.3-04, Personal Gifts (10/07/2020). When a gift of equity is provided by an acceptable donor, the donor is not considered to be an interested party and the gift of equity is not subject to Fannie Mae’s interested party contribution requirements (see B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019)).

### Documentation Requirements

The following documents must be retained in the loan file:

- a signed gift letter (see B3-4.3-04, Personal Gifts (10/07/2020)), and
- the settlement statement listing the gift of equity.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-06	October 07, 2020
Announcement SEL-2012-13	November 13, 2012
Announcement -2009-32	July 1, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-06, Grants and Lender Contributions (12/16/2020)

REVISION HISTORY 05/01/2018

REVISION NUMBER: 05012018 DATE: 05/01/2018

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-4.3-06, Donations From Entities (05/01/2018)

#### Introduction

This topic contains information on donations from entities, including:

- Donations From Entities
- Minimum Borrower Contribution Requirements
- Documentation Requirements
- Lender Contributions

#### Donations From Entities

A borrower of a mortgage loan secured by a principal residence may use donated gift or grant funds from acceptable entities to fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements described below. Down payment assistance may not be funded in any way through the first lien mortgage, such as premium pricing.

Donated gift or grant funds may also be applied towards energy-related improvements if

- the program under which the funds are made available allows such a use, and
- the minimum borrower contribution requirements are met.

Donated gifts and grants are not allowed on a second home or an investment property.

Acceptable entities include churches, municipalities, nonprofit organizations (excluding credit unions), regional Federal Home Loan Banks under one of their affordable housing programs, federally recognized Native American tribes and their sovereign instrumentalities, and public agencies.

#### Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain donated gifts or grants.

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower’s Own Funds	
80% or less	One- to four-unit principal residence	A minimum borrower contribution from the borrower’s own funds is not required. All funds needed to complete the transaction can come from a donated gift or grant.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower’s own funds is not required. All funds

		needed to complete the transaction can come from a donated gift or grant.
	Two- to four-unit principal residence	The borrower must make a 5% minimum borrower contribution from his or her own funds. After the minimum borrower contribution has been met, donated gifts or grants can be used to supplement the down payment, closing costs, reserves, and energy-related improvements.  See B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for HomeReady mortgage minimum borrower contribution and down payment requirements.

### Documentation Requirements

The donated gift or grant must be documented with either a copy of the letter awarding the gift or grant to the borrower or a copy of the legal agreement that specifies the terms and conditions of the gift or grant. The document must include language indicating that repayment of the gift or grant is not expected, and how the funds will be transferred to the borrower, lender, or closing agent.

The transfer of gifts or grants must be documented with a copy of the donor's canceled check, a copy of the settlement statement showing receipt of the check, or similar evidence. The documentation must be included in the individual mortgage file.

### Lender Contributions

The lender may provide the borrower with a contribution to fund borrower-paid closing costs and prepaid fees in the following cases:

- The lender credit is derived from premium pricing, as described in *Premium Pricing* in B2-1.5-02, Loan Eligibility (09/02/2020).
- The lender credit is sourced directly from lender funds with no expectation for repayment or financial obligation apart from the subject mortgage. Funds passed to the lender from a third party, for the purpose of providing a lender credit, are not eligible as a lender contribution.

The amount of the lender contribution should not exceed the amount of borrower-paid closing costs and prepaid fees and may not be used to fund any portion of the down payment or financial reserve requirements.

When the lender is an interested party to a purchase transaction, any amount of a lender contribution not derived from premium pricing, must be considered as an IPC when calculating the maximum IPC limit for eligibility purposes.

Any excess lender credit required to be returned to the borrower in accordance with applicable regulatory requirements is considered an overpayment of fees and charges and may be applied as a principal curtailment or returned in cash to the borrower. See B2-1.3-01, Purchase Transactions (10/02/2019) and B2-1.3-02, Limited Cash-Out Refinance Transactions (06/03/2020) for treatment of the overpayment of fees and charges.

Lenders may also provide borrowers with cash or cash-like incentives that do not need to be reflected on the settlement statement. See B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019) for additional information.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2018-04	May 01, 2018
Announcement SEL-2018-03	April 03, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2016-03	March 29, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2014-07	June 24, 2014
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010

### B3-4.3-06, Grants and Lender Contributions (12/16/2020)

#### Introduction

This topic contains information on grants and lender contributions, including:

- Donations From Entities - Grants
- Minimum Borrower Contribution Requirements
- Documentation Requirements
- Lender Contributions

#### Donations From Entities - Grants

A borrower of a mortgage loan secured by a principal residence may use donated funds from acceptable entities to fund all or part of the down payment, closing costs, or financial reserves subject to the minimum borrower contribution requirements described below. Donated funds from an entity are referred to as a grant. Down payment assistance may not be funded in any way through the first lien mortgage, such as premium pricing.

Grant funds may also be applied towards energy-related improvements if

- the program under which the funds are made available allows such a use, and
- the minimum borrower contribution requirements are met.

Grants are not allowed on a second home or an investment property.

Acceptable entities providing a grant include churches, employers, municipalities, nonprofit organizations (excluding credit unions), regional Federal Home Loan Banks under one of their affordable housing programs, federally recognized Native American tribes and their sovereign instrumentalities, and public agencies.

See B3-4.3-08, Employer Assistance (09/29/2015) for additional information about grants from employers.

### Minimum Borrower Contribution Requirements

The following table describes the minimum borrower contribution requirements for transactions that contain grants.

LTV, CLTV, or HCLTV Ratio	Minimum Borrower Contribution Requirement from Borrower's Own Funds	
80% or less	One- to four-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a grant.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from a grant.
	Two- to four-unit principal residence	The borrower must make a 5% minimum borrower contribution from his or her own funds. After the minimum borrower contribution has been met, grants can be used to supplement the down payment, closing costs, reserves, and energy-related improvements.  See B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for HomeReady mortgage minimum borrower contribution and down payment requirements.

### Documentation Requirements

The grant must be documented with either a copy of the letter awarding the grant to the borrower or a copy of the legal agreement that specifies the terms and conditions of the grant. The document must include language indicating that repayment of the grant is not expected, and how the funds will be transferred to the borrower, lender, or closing agent.

The transfer of grants must be documented with a copy of the donor's canceled check, a copy of the settlement statement showing receipt of the check, or similar evidence. The documentation must be included in the individual mortgage file.

### Lender Contributions

The lender may provide the borrower with a contribution to fund borrower-paid closing costs and prepaid fees in the following cases:

- The lender credit is derived from premium pricing, as described in *Premium Pricing* in B2-1.5-02, Loan Eligibility (12/16/2020).
- The lender credit is sourced directly from lender funds with no expectation for repayment or financial obligation apart from the subject mortgage. Funds passed to the lender from a third party, for the purpose of providing a lender credit, are not eligible as a lender contribution.

The amount of the lender contribution should not exceed the amount of borrower-paid closing costs and prepaid fees and may not be used to fund any portion of the down payment or financial reserve requirements. Lender contributions are not considered grants.

When the lender is an interested party to a purchase transaction, any amount of a lender contribution not derived from premium pricing, must be considered as an IPC when calculating the maximum IPC limit for eligibility purposes.

Any excess lender credit required to be returned to the borrower in accordance with applicable regulatory requirements is considered an overpayment of fees and charges and may be applied as a principal curtailment or returned in cash to the borrower. See B2-1.3-01, Purchase Transactions (12/16/2020) and B2-1.3-02, Limited Cash-Out Refinance Transactions (06/03/2020) for treatment of the overpayment of fees and charges.

Lenders may also provide borrowers with cash or cash-like incentives that do not need to be reflected on the settlement statement. See B3-4.1-02, Interested Party Contributions (IPCs) (08/07/2019) for additional information.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2018-04	May 01, 2018
Announcement SEL-2018-03	April 03, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2016-03	March 29, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2014-07	June 24, 2014

Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-07, Disaster Relief Grants or Loans (04/01/2009)

### **B3-4.3-07, Disaster Relief Grants or Loans (04/01/2009)**

#### **Introduction**

This topic contains information on disaster relief grants or loans.

#### **Disaster Relief Grant or Loan**

Borrowers may use lump-sum disaster relief grants or loans to satisfy Fannie Mae's minimum borrower contribution requirement. No borrower contribution is required.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-08, Employer Assistance (09/29/2015)

### **B3-4.3-08, Employer Assistance (09/29/2015)**

#### **Introduction**

This topic contains information on employer assistance, including:

- Forms of Employer Assistance
- Minimum Borrower Contribution Requirements
- Documentation Requirements

#### **Forms of Employer Assistance**

The employer assistance may be in the form of:

- a grant,
- a direct, fully repayable second mortgage or unsecured loan,
- a forgivable second mortgage or unsecured loan, or
- a deferred-payment second mortgage or unsecured loan.

A borrower of a mortgage loan secured by a principal residence may use funds provided by an employer to fund all or part of the down payment or closing costs subject to the minimum borrower contribution requirements below. Employer assistance can also be used for financial reserves for all types of assistance with the exception of unsecured loans (which may only be used for the down payment and closing costs). Employer assistance funds are not allowed on a second home or an investment property.

Funds must come directly from the employer, including through an employer-affiliated credit union.

When employer assistance is extended as a secured second mortgage, the transaction may be structured as a Community Seconds (see B5-5.1-02, Community Seconds Loan Eligibility (06/05/2018)) or it must satisfy Fannie Mae's eligibility criteria for mortgages that are subject to subordinate financing (see B2-1.2-04, Subordinate Financing (08/07/2019)).

If the secured second mortgage or unsecured loan does not require regular payments of either principal and interest or interest only, the lender does not need to calculate an equivalent payment for consideration as part of the borrower's monthly debt. If regular payments are required for the secured second mortgage, the payments must be included in the calculation of the debt-to-income ratio.

#### **Minimum Borrower Contribution Requirements**

The following table describes the minimum borrower contribution requirements for transactions that contain employer assistance.

<b>LTV, CLTV, or HCLTV Ratio</b>	<b>Minimum Borrower Contribution Requirement from Borrower's Own Funds</b>	
80% or less	One- to four-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from employer assistance.
Greater than 80%	One-unit principal residence	A minimum borrower contribution from the borrower's own funds is not required. All funds needed to complete the transaction can come from employer assistance.
	Two- to four-unit principal residence	The borrower must make a 5% minimum borrower contribution from his or her own funds. After the minimum borrower contribution has been met, employer assistance can be used to supplement the down payment, closing costs, and reserves (except for unsecured loans, which may not be applied to reserves).  See B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for HomeReady mortgage minimum borrower contribution and down payment requirements.

#### **Documentation Requirements**

The lender must document:

- that the program is an established company program, not just an accommodation developed for an individual employee.
- the dollar amount of the employer's assistance.
- an unsecured loan from an employer with an award letter or legal agreement from the note holder and must disclose the terms and conditions of the loan.
- the terms of any other employee assistance being offered to the borrower (such as relocation benefits or gifts).
- that the borrower received the employer assistance funds directly from the employer (or through the employer-affiliated credit union).

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-09, Earnest Money Deposit (08/21/2012)

### B3-4.3-09, Earnest Money Deposit (08/21/2012)

#### Introduction

This topic contains information on the earnest money deposit, including:

- Sales Contract Deposit
- Verification of Source of Funds
- Documentation for Receipt of the Deposit

#### Sales Contract Deposit

The deposit on the sales contract (earnest money) for the purchase of the security property is an acceptable source of funds for both the down payment and the closing costs.

#### Verification of Source of Funds

If the deposit is being used as part of the borrower's minimum contribution requirement, the lender must verify that the funds are from an acceptable source. See B3-4.2-01, Verification of Deposits and Assets (04/25/2017).

A *Request for Verification of Deposit* (Form 1006 or Form 1006(S)) must indicate that the average balance for the past two months was large enough to support the amount of the deposit.

Bank statements must evidence that the average balance for the past two months was large enough to support the amount of the deposit. If a copy of the canceled deposit check is used to document the source of funds, the bank statements must cover the period up to (and including) the date the check cleared the bank account.

If it cannot be determined that these funds were withdrawn from the borrower's account, additional verification of the source and evidence that the funds have actually changed hands from the borrower to the seller, the realtor, the escrow agent, or the settlement attorney should be provided. Large earnest money deposits and deposits that exceed the amount customary for the area should be closely evaluated.

#### Documentation for Receipt of the Deposit

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.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2012-07	August 21, 2012

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-10, Anticipated Sales Proceeds (02/23/2016)

### B3-4.3-10, Anticipated Sales Proceeds (02/23/2016)

#### Introduction

This topic contains information on anticipated sales proceeds, including:

- Anticipated Sales Proceeds
- Determining the Amount of Net Proceeds
- Sales Proceeds Needed for Down Payment and Closing Costs
- Like-Kind Exchanges
- Employee Relocation

#### Anticipated Sales Proceeds

If the borrower's currently owned home is listed for sale but has not been sold, the lender may qualify the borrower on the basis of anticipated sales proceeds.

The lender must document the actual proceeds received by the borrower.

### Determining the Amount of Net Proceeds

The following table describes how to determine the amount of net proceeds based on a borrower's anticipated equity.

Sales Price Established?	Net Proceeds Calculation
Yes	Sales Price – (Sales Costs + All Liens) = Estimated Proceeds
No	90% of Listing Price – All Liens = Estimated Proceeds <b>Note:</b> The 10% adjustment factor that is applied to the listing price must be changed depending on market conditions.

### Sales Proceeds Needed for Down Payment and Closing Costs

If the proceeds from the sale of a currently owned home are needed for the down payment and closing costs on the new house, the lender must verify the source of funds by obtaining a copy of the settlement statement on the existing home before, or simultaneously with, the settlement on the new home, showing sufficient net cash proceeds to consummate the purchase of the new home.

### Like-Kind Exchanges

Assets for the down payment from a "like-kind exchange," also known as a 1031 exchange, are eligible if properly documented and in compliance with Internal Revenue Code Section 1031.

### Employee Relocation

When the borrower's employer assumes responsibility for paying off the existing mortgage in connection with a relocation plan, the lender must obtain a copy of the executed buy-out agreement to document the source of funds. A photocopy of a sales contract or a listing agreement is not considered an acceptable source of verification of proceeds from the sale.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2016-02	February 23, 2016
Announcement SEL-2015-12	November 3, 2015
Announcement SEL-2014-06	May 27, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-11, Trade Equity (12/16/2020)

REVISION HISTORY 12/01/2010

REVISION NUMBER: 12012010 DATE: 12/01/2010

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-4.3-11, Trade Equity (12/01/2010)

#### Introduction

This topic contains information on trade equity, including:

- Trade Equity
- Calculating the Equity Contribution
- Documentation Requirements

#### Trade Equity

Trade equity is an acceptable source of funds to supplement the borrower's minimum borrower contribution provided the following requirements are met:

- The seller's equity contribution for the traded property must be a true-value consideration supported by a current appraisal.
- The borrower must make the minimum required contribution from his or her own funds unless:
  - the LTV or CLTV ratio is less than or equal to 80%; or
  - the borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower's minimum contribution. See B3-4.3-04, Personal Gifts (10/07/2020); B3-4.3-06, Donations From Entities (05/01/2018); and B3-4.3-08, Employer Assistance (09/29/2015), for additional information.

These requirements apply to all transactions that involve property trades, including those that are evidenced by two separate contracts that have the buyer and the seller on one contract reversing roles on the second contract.

#### Calculating the Equity Contribution

The equity contribution is determined by subtracting the outstanding mortgage balance of the property being traded, plus any transfer costs, from the lesser of either the property's appraised value or the trade-in value agreed to by both parties.

For trade equity requirements for manufactured housing, see Section B5-2-03, Manufactured Housing Underwriting Requirements.

## Documentation Requirements

For real property, the transfer deed must be recorded.

In addition, lenders must obtain the following:

- A search of the land records to verify the ownership of the property and to determine whether there are any existing liens on the property.
- Proof of title transfer and satisfaction of any existing mortgage liens for which the borrower was liable.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2010-16	December 1, 2010

## B3-4.3-11, Trade Equity (12/16/2020)

### Introduction

This topic contains information on trade equity, including:

- Trade Equity
- Calculating the Equity Contribution
- Documentation Requirements

### Trade Equity

Trade equity is an acceptable source of funds to supplement the borrower's minimum borrower contribution provided the following requirements are met:

- The seller's equity contribution for the traded property must be a true-value consideration supported by a current appraisal.
- The borrower must make the minimum required contribution from his or her own funds unless:
  - the LTV or CLTV ratio is less than or equal to 80%; or
  - the borrower is purchasing a one-unit principal residence and meets the requirements to use gifts, donated grant funds, or funds received from an employer to pay for some or all of the borrower's minimum contribution. See B3-4.3-04, Personal Gifts (10/07/2020); B3-4.3-06, Grants and Lender Contributions (12/16/2020); and B3-4.3-08, Employer Assistance (09/29/2015), for additional information.

These requirements apply to all transactions that involve property trades, including those that are evidenced by two separate contracts that have the buyer and the seller on one contract reversing roles on the second contract.

**Note:** Trade equity is entered in the loan application as a credit to the transaction, which will reduce the borrower's required funds to close.

### Calculating the Equity Contribution

The equity contribution is determined by subtracting the outstanding mortgage balance of the property being traded, plus any transfer costs, from the lesser of either the property's appraised value or the trade-in value agreed to by both parties.

For trade equity requirements for manufactured housing, see Section B5-2-03, Manufactured Housing Underwriting Requirements.

## Documentation Requirements

For real property, the transfer deed must be recorded.

In addition, lenders must obtain the following:

- A search of the land records to verify the ownership of the property and to determine whether there are any existing liens on the property.
- Proof of title transfer and satisfaction of any existing mortgage liens for which the borrower was liable.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2010-16	December 1, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-12, Rent Credit for Option to Purchase (04/01/2009)

## B3-4.3-12, Rent Credit for Option to Purchase (04/01/2009)

### Introduction

This topic contains information on rent credit for option to purchase, including:

- Rent Credit for Option to Purchase
- Documentation Requirements

## Rent Credit for Option to Purchase

Rent credit for option to purchase is an acceptable source of funds toward the down payment or minimum borrower contribution. Borrowers are not required to make a minimum borrower contribution from their own funds in order for the rental payments to be credited toward the down payment.

Credit for the down payment is determined by calculating the difference between the market rent and the actual rent paid for the last 12 months. The market rent is determined by the appraiser in the appraisal for the subject property.

## Documentation Requirements

The lender must obtain the following documentation:

- A copy of the rental/purchase agreement evidencing a minimum original term of at least 12 months, clearly stating the monthly rental amount and specifying the terms of the lease.
- Copies of the borrower's canceled checks or money order receipts for the last 12 months evidencing the rental payments.
- Market rent as determined by the subject property appraisal.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-13, Sweat Equity (04/15/2014)

### B3-4.3-13, Sweat Equity (04/15/2014)

#### Introduction

This topic contains information on sweat equity.

#### Sweat Equity

Generally, sweat equity is not an acceptable source of funds for the down payment, closing costs, and reserves, since it is difficult to accurately assess the contributory value of sweat equity work. Only for specific transactions and if all eligibility requirements are met does Fannie Mae consider sweat equity to be an acceptable source of funds.

For further detail on the specific transactions and the eligibility requirements to be met, see Chapter B5-6, HomeReady Mortgage.

#### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2014-03	April 15, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-14, Bridge/Swing Loans (04/01/2009)

### B3-4.3-14, Bridge/Swing Loans (04/01/2009)

#### Introduction

This topic contains information on bridge/swing loans.

#### Bridge/Swing Loans

A bridge (or swing) loan is an acceptable source of funds provided the following requirements are met:

- The bridge loan cannot be cross-collateralized against the new property.
- The 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.

Fannie Mae does not have a specified limitation on the term of bridge loans. See B3-6-05, Monthly Debt Obligations (12/16/2020), for more information about how to treat the resulting contingent liability.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-15, Borrowed Funds Secured by an Asset (10/30/2009)

### B3-4.3-15, Borrowed Funds Secured by an Asset (10/30/2009)

#### Introduction

This topic contains information on borrowed funds secured by an asset, including:

- Borrowed Funds Secured by an Asset
- Secured Loans as Debt
- Reducing the Asset by the Amount Borrowed
- Documentation Requirements

#### Borrowed Funds Secured by an Asset

Borrowed funds secured by an asset are an acceptable source of funds for the down payment, closing costs, and reserves, since borrowed funds secured by an asset represent a return of equity.

Assets that may be used to secure funds include automobiles, artwork, collectibles, real estate, or financial assets, such as savings accounts, certificates of deposit, stocks, bonds, and 401(k) accounts.

#### Secured Loans as Debt

When qualifying the borrower, the lender must consider monthly payments for secured loans as a debt.

If a secured loan does not require monthly payments, the lender must calculate an equivalent amount and consider that amount as a recurring debt.

When loans are secured by the borrower's financial assets, monthly payments for the loan do not have to be considered as long-term debt.

### Reducing the Asset by the Amount Borrowed

If the borrower uses the same financial asset as part of his or her financial reserves, the lender must reduce the value of the asset by the amount of proceeds and related fees for the secured loan.

### Documentation Requirements

The lender must document the following:

- the terms of the secured loan,
- evidence that the party providing the secured loan is not a party to the sale, and
- evidence that the funds have been transferred to the borrower.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement –2009–32	October 30, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-16, Credit Card Financing (12/16/2020)

#### REVISION HISTORY 10/30/2009

REVISION NUMBER: 10302009      DATE: 10/30/2009

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-4.3-16, Credit Card Financing (10/30/2009)

#### Introduction

This topic contains information on credit card financing.

#### Credit Card Financing

Fannie Mae permits certain costs that must be paid early in the application process, such as lock-in fees, origination fees, commitment fees, credit report fees, and appraisal fees, to be charged to the borrower's credit card because these fees do not represent extraordinary amounts and the credit card debt is considered in the borrower's total monthly debt-to-income ratio. Borrowers are not required to pay off these credit card changes before closing. Under no circumstances may credit card financing be used for the down payment.

Lenders may allow credit card financing for the payment of common and customary fees paid outside of closing up to a maximum of 2% of the loan amount if the lender:

- confirms that the borrower has sufficient liquid funds (financial reserves) to cover these charges (in addition to funds needed for other closing costs and the down payment that he or she will be paying); or
- recalculates the credit card payment, per B3-6-05, Monthly Debt Obligations (02/05/2020), to account for the new charges and includes the updated payment in the qualifying ratio calculation.

For DU, lenders must apply this policy manually, by either including the fees charged to the borrower's credit card on line f. Estimated Closing Costs of the Details of Transaction, and removing any "Borrower Paid Fees" entered in the Other Credits section of the Details of Transaction for the fees paid outside of closing; or by increasing the monthly credit card payment in the liabilities section of the loan casefile submitted to DU to include the charges if not reflected in the credit report.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement –2009–19	June 8, 2009

### B3-4.3-16, Credit Card Financing (12/16/2020)

#### Introduction

This topic contains information on credit card financing.

#### Credit Card Financing

Fannie Mae permits certain costs that must be paid early in the application process, such as lock-in fees, origination fees, commitment fees, credit report fees, and appraisal fees, to be charged to the borrower's credit card because these fees do not represent extraordinary amounts and the credit card debt is considered in the borrower's total monthly debt-to-income ratio. Borrowers are not required to pay off these credit card changes before closing. Under no circumstances may credit card financing be used for the down payment.

Lenders may allow credit card financing for the payment of common and customary fees paid outside of closing up to a maximum of 2% of the loan amount if the lender:

- confirms that the borrower has sufficient liquid funds (financial reserves) to cover these charges (in addition to funds needed for other closing costs and the down payment that he or she will be paying); or

- recalculates the credit card payment, per B3-6-05, Monthly Debt Obligations (12/16/2020), to account for the new charges and includes the updated payment in the qualifying ratio calculation.

For DU, lenders must apply this policy manually. The fees charged to the borrower's credit card must be included as a closing cost in the loan application, and removed from any Borrower Paid Fees entered as an other credit for the fees paid outside of closing. Alternatively, the monthly credit card payment in the liabilities section of the loan application must be increased to include the charges if not reflected in the credit report.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-17, Personal Unsecured Loans (09/20/2010)

### B3-4.3-17, Personal Unsecured Loans (09/20/2010)

#### Introduction

This topic contains information on personal unsecured loans.

#### Personal Unsecured Loans

Personal unsecured loans are not an acceptable source of funds for the down payment, closing costs, or financial reserves.

Examples of personal unsecured loans include signature loans, lines of credit on credit cards, and overdraft protection on checking accounts.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2010-13	September 20, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-18, Sale of Personal Assets (12/16/2020)

#### REVISION HISTORY 04/01/2009

REVISION NUMBER: 04012009 DATE: 04/01/2009

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-4.3-18, Sale of Personal Assets (04/01/2009)

#### Introduction

This topic contains information on the sale of personal assets, including:

- Sale of Personal Assets
- Documentation Requirements

#### Sale of Personal Assets

Proceeds from the sale of personal assets are an acceptable source of funds for the down payment, closing costs, and reserves provided the individual purchasing the asset is not a party to the property sale transaction or the mortgage financing transaction.

#### Documentation Requirements

The lender must document the following:

- The borrower's ownership of the asset.
- The value of the asset, as determined by an independent and reputable source.
- The transfer of ownership of the asset, as documented by either a bill of sale or a statement from the purchaser.
- The borrower's receipt of the sale proceeds from documents such as deposit slips, bank statements, or copies of the purchaser's canceled check.

Depending on the significance of the funds in question, the lender may accept alternatives to this required documentation, particularly when the proceeds of the sale represent a minor percentage of the borrower's overall financial contribution.

### B3-4.3-18, Sale of Personal Assets (12/16/2020)

#### Introduction

This topic contains information on the sale of personal assets, including:

- Sale of Personal Assets
- Documentation Requirements

#### Sale of Personal Assets

Proceeds from the sale of personal assets are an acceptable source of funds for the down payment, closing costs, and reserves provided the individual purchasing the asset is not a party to the property sale transaction or the mortgage financing transaction.

### Documentation Requirements

The lender must document the following:

- The borrower's ownership of the asset for all asset types that are titled assets, for example automobile title.
- The value of the asset, as determined by an independent and reputable source, if the proceeds represent more than 50% of the total monthly income used in qualifying. The lender must use the lesser of the estimated value (as determined by the independent source) or actual sales price when determining the amount of funds for the transaction. For example, a borrower plans to sell their vehicle. The value as determined by an independent source is \$10,000; the sales price of the vehicle is \$12,000. \$10,000 can be added to the borrower's available funds even if the sale has already occurred.
- The transfer of ownership of the asset, as documented by either a bill of sale or a statement from the purchaser.
- The borrower's receipt of the sale proceeds from documents such as deposit slips, bank statements, copies of the purchaser's canceled check or an equivalent payment source.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-19, Cash Value of Life Insurance (05/27/2014)

### B3-4.3-19, Cash Value of Life Insurance (05/27/2014)

#### Introduction

This topic contains information on the cash value of life insurance, including:

- Cash Value of Life Insurance and Debt-to-Income Ratios
- Documenting Borrower Receipt of Funds

#### Cash Value of Life Insurance and Debt-to-Income Ratios

Net proceeds from a loan against the cash value or from the surrender of a life insurance policy are an acceptable source of funds for the down payment, closing costs, and reserves.

The lender must assess repayment or additional obligation considerations to determine the impact on borrower qualification or reserves.

If penalties for failure to repay the loan are limited to the surrender of the policy, payments on a loan secured by the cash value of a borrower's life insurance policy do not have to be considered in the total debt-to-income ratio.

If additional obligations are indicated, the obligation amount must be factored into the total debt-to-income ratio, or subtracted from the borrower's financial reserves.

#### Documenting Borrower Receipt of Funds

If the funds are needed for the down payment or closing costs, lenders must document the borrower's receipt of the funds from the insurance company by obtaining either a copy of the check from the insurer or a copy of the payout statement issued by the insurer. If the cash-value of the life insurance is being used for reserves, the cash-value must be documented but does not need to be liquidated and received by the borrower.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2014-06	May 27, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.3, Verification of Non-Depository Assets > B3-4.3-20, Anticipated Savings and Cash-on-Hand (04/01/2009)

### B3-4.3-20, Anticipated Savings and Cash-on-Hand (04/01/2009)

#### Introduction

This topic contains information on:

- Anticipated Savings
- Cash-on-Hand

#### Anticipated Savings

The lender may preliminarily qualify a borrower on the basis that anticipated savings will be sufficient to meet the funds needed for closing. The lender must verify that savings are actually accumulated by the borrower before loan closing.

The estimate for a borrower's anticipated savings must be realistically developed. To calculate potential saved funds, the lender should reduce the borrower's expected after-tax income for the expected savings period by existing housing expenses, monthly debt expenses based on data from the credit report, and expected living expenses, such as food, transportation, etc.

## Cash-on-Hand

Cash-on-hand is not an acceptable source of funds for the down payment or closing costs.

For HomeReady mortgages, cash-on-hand may be considered an acceptable source of funds for the down payment and closing cost. See Chapter B5-6, HomeReady Mortgage.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.4, DU Requirements for Asset Assessment > B3-4.4-01, DU Asset Verification (12/16/2020)

### REVISION HISTORY 04/03/2018

REVISION NUMBER: 04032018      DATE: 04/03/2018

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-4.4-01, Asset Verification (04/03/2018)

### Introduction

This topic contains information on asset verification for mortgages underwritten with DU, including:

- Liquid Assets
- Non-Liquid Assets
- Reserve Requirements
- Asset Values in the DU Underwriting Findings Report
- Non-Occupant Borrower Asset Requirements

### Liquid Assets

DU analyzes the value of liquid assets entered in the online application in its risk assessment. Assets may be excluded from the online application if the borrower can qualify without them.

The online loan application provides the following categories of liquid assets: Bond, Bridge Loan, Cash-on-Hand (for HomeReady mortgages only), Certificate of Deposit, Checking Account, Gift, Gift of Equity, Money Market Fund, Mutual Fund, Net Equity, Other Liquid Asset, Retirement Fund, Savings Account, Secured Borrowed Funds, Stock, and Trust Funds.

### Non-Liquid Assets

DU does not consider the amount of non-liquid assets. Non-liquid assets do not have to be verified, and will not be identified in a verification message.

The online loan application provides the following categories of non-liquid assets: Cash Deposit on Sales, Net Worth of Business, and Other Non-Liquid Asset.

### Reserve Requirements

For loan casefiles underwritten with DU, DU will determine the reserve requirements based on the overall risk assessment of the loan casefile and the minimum reserves that may be required for the transaction. Reserves may be considered a compensating factor in DU's risk analysis, and may serve to improve the underwriting recommendation.

Refer to the following topics for additional requirements related to minimum reserves:

- B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019)
- B3-4.1-01, Minimum Reserve Requirements (10/07/2020)

### Asset Values in the DU Underwriting Findings Report

The DU Underwriting Findings report will identify the following values:

- "Total Available Assets," which is the total of all borrower(s)' liquid assets entered into DU;
- "Funds Required to Close," which will include the cash needed to complete the transaction plus any debts marked paid by closing on purchase or limited cash-out refinance transactions, other than subject property mortgage(s);
- "Reserves Required to be Verified," which is the amount of reserves that must be verified;
- "Total Funds to be Verified," which is the sum of the "Funds Required to Close" and the "Reserves Required to be Verified"; and
- "Excess Available Assets, not required to be verified by DU," which are liquid assets that DU is not requiring the lender to verify.

The Excess Available Assets, not required to be verified by DU (Excess Available Assets) amount represents the amount of assets remaining after subtracting the Total Funds to be Verified from the Total Available Assets. Excess Available Assets do not generally need to be verified.

### Non-Occupant Borrower Asset Requirements

Assets that are owned by a non-occupant borrower can be included in the 5% minimum borrower contribution requirement (when applicable), and those funds must be entered in the online loan application. Total liquid assets for the occupying borrower and non-occupant borrower are included in DU's calculation of total available assets.

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2018-03	April 03, 2018
Announcement SEL-2014-07	June 24, 2014
Announcement SEL-2012-07	August 21, 2012
DU Version 9.0	July 24, 2012

Announcement SEL-2012-01	January 31, 2012
Announcement SEL-2010-06	April 30, 2010
DU Version 8.0	September 22, 2009
Announcement -2009-02	February 6, 2009

### B3-4.4-01, DU Asset Verification (12/16/2020)

#### Introduction

This topic contains information on asset verification for loans underwritten with DU, including:

- Liquid Assets
- Non-Liquid Assets
- Reserve Requirements
- Asset Values in the DU Underwriting Findings Report
- Non-Occupant Borrower Asset Requirements

#### Liquid Assets

DU analyzes the value of liquid assets entered in the loan application in its risk assessment. Assets may be excluded from the loan application if the borrower can qualify without them.

DU considers the following assets liquid assets: Bonds, Bridge Loan Proceeds, Cash-on-Hand (for certain HomeReady loans only), Cash Value of Life Insurance, Certificate of Deposit, Checking, Gift (not deposited), Gift of Equity, Grant (not deposited), Individual Development Account, Money Market, Mutual Fund, Net Equity, Other Liquid Asset, Proceeds from Real Estate Property to be sold on or before closing, Proceeds from Sale of Non-Real Estate Asset, Retirement, Savings, Secured Borrowed Funds, Stocks, Stock Options (vested), and Trust Account.

**Note:** Some of these asset types may not be available in the lender's loan origination system.

#### Non-Liquid Assets

DU does not consider the amount of non-liquid assets. Non-liquid assets do not have to be verified, and will not be identified in a verification message.

DU considers the following assets non-liquid assets: Cash Deposit on Sales, Net Worth of Business, Other Non-Liquid Asset, and Unsecured Borrowed Funds.

**Note:** Some of these asset types may not be available in the lender's loan origination system. ®

#### Reserve Requirements

For loan casefiles underwritten with DU, DU will determine the reserve requirements based on the overall risk assessment of the loan casefile and the minimum reserves that may be required for the transaction. Reserves may be considered a compensating factor in DU's risk analysis, and may serve to improve the underwriting recommendation.

Refer to the following topics for additional requirements related to minimum reserves:

- B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020)
- B3-4.1-01, Minimum Reserve Requirements (10/07/2020)

#### Asset Values in the DU Underwriting Findings Report

The DU Underwriting Findings report will identify the following values:

- Total Available Assets: the total of all borrower(s)' liquid assets entered into DU;
- Funds Required to Close: includes the cash needed to complete the transaction plus any debts marked paid by closing on purchase or limited cash-out refinance transactions, other than subject property mortgage(s);
- Reserves Required to be Verified: the amount of reserves that must be verified;
- Total Funds to be Verified: the sum of Funds Required to Close and Reserves Required to be Verified; and
- Excess Available Assets, not required to be verified by DU: liquid assets that DU is not requiring the lender to verify.

The Excess Available Assets, not required to be verified by DU (Excess Available Assets) amount represents the amount of assets remaining after subtracting the Total Funds to be Verified from the Total Available Assets. Excess Available Assets do not generally need to be verified.

#### Non-Occupant Borrower Asset Requirements

Assets that are owned by a non-occupant borrower can be included in the 5% minimum borrower contribution requirement (when applicable), and those funds must be entered in the loan application. Total liquid assets for the occupying borrower and non-occupant borrower are included in DU's calculation of total available assets.

#### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2018-03	April 03, 2018
Announcement SEL-2014-07	June 24, 2014
Announcement SEL-2012-07	August 21, 2012

DU Version 9.0	July 24, 2012
Announcement SEL-2012-01	January 31, 2012
Announcement SEL-2010-06	April 30, 2010
DU Version 8.0	September 22, 2009
Announcement -2009-02	February 6, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-4, Asset Assessment > Section B3-4.4, DU Requirements for Asset Assessment > B3-4.4-02, Requirements for Certain Assets in DU (12/16/2020)

**REVISION HISTORY 12/06/2016**

**REVISION NUMBER:** 12062016      **DATE:** 12/06/2016

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

**B3-4.4-02, Documentation Requirements (12/06/2016)**

**Introduction**

This topic contains information on DU documentation requirements, including:

- Asset Verification Documentation
- Depository Assets
- Bridge Loan (Liquid Asset)
- Cash Deposit on Sales Contract (Earnest Money)
- Gifts
- Gifts of Equity
- Net Equity (From Properties Pending Sale)
- Net Worth of Business
- Other Liquid Asset
- Proceeds From Sold Properties
- Secured Borrowed Funds

**Asset Verification Documentation**

DU indicates the minimum verification documentation requirements necessary for the lender to process the loan application. This level of documentation may not be adequate for every borrower and every situation. The lender must determine whether additional documentation is warranted.

**Depository Assets**

For depository assets (checking and savings accounts, money market funds, and certificates of deposit), DU will require two consecutive monthly bank statements (60 days of account activity).

Monthly bank statements must be dated within 45 days of the initial loan application date.

Quarterly bank statements must be dated within 90 days of the initial loan application date, and the lender must confirm that the funds in the account have not been transferred to another asset account that is verified with more current documentation.

A *Verification of Deposit* (Form 1006 or Form 1006(S)) can be obtained in place of bank statements.

When DU validates assets, DU issues a message indicating the acceptable documentation. Compliance with the DU message satisfies the requirement for documenting assets. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020)

**Bridge Loan (Liquid Asset)**

Enter the amount of a bridge/swing loan under Bridge Loan in Section VI Assets. Do not include the amount of the bridge loan in any other liquid asset. (For example, do not enter the amount of the loan both as a bridge loan and in a checking account, even if the loan funds have been deposited.)

Bridge loans should also be considered in the Net Equity calculation for properties that are Pending Sale. (In other words, the amount of the bridge loan should be subtracted from the net proceeds to avoid counting this asset twice.)

**Note:** It may also be necessary to enter the bridge loan as a recurring liability in Section VI, Liabilities, with the corresponding monthly payment. See the bridge loan liability discussion in B3-6-05, Monthly Debt Obligations (02/05/2020).

**Cash Deposit on Sales Contract (Earnest Money)**

When cash deposit on sales contract (earnest money) is entered in Section VI Assets, DU does not consider it liquid. Therefore, in order to give the borrower credit for earnest money that is not already reflected in a liquid account, the lender must enter the earnest money amount as follows:

- If the earnest money check has not cleared the borrower's bank account, the amount can be included in a depository account, such as a checking or savings account.
- If the earnest money check has cleared the borrower's bank account, the amount can be entered as Other Credit in Section VII, where it is assumed to be verified.

Do not enter the amount in both places.

**Gifts**

Gifts or donations from entities (grants) are permitted in accordance with B3-4.3-04, Personal Gifts (10/07/2020), and B3-4.3-06, Donations From Entities (05/01/2018). The entry of gifts or grants on the online loan application is as follows:

- When a gift is entered in Section VI Assets as a gift, the funds are included in available funds. It is important that the gift amount is identified separately as a gift even if the funds have already been deposited in a liquid asset account owned by the borrower (such as a checking or savings account). The balance of the liquid asset account entered in the loan application must be adjusted accordingly to prevent duplicate entry of funds. For example, if the borrower's verified checking account reflects a balance of \$15,000, and \$5,000 of that amount was from a gift, the checking account balance should be adjusted to reflect \$10,000, and the \$5,000 should be entered separately as a gift.
- When a gift is entered in Section II as a source of down payment, the funds are not included in the available funds.

**Note:** Gift funds are considered liquid only when the funds are entered as Gift in Section VI Assets.

Some loan origination systems (LOS) may not provide a "gift" data entry option, or the gift entry may not map correctly to DU. (For example, the LOS may identify the gift as a checking account when the data is transmitted to DU.) The lender must ensure that gift information has been properly identified in DU.

For gift documentation requirements, see B3-4.3-04, Personal Gifts (10/07/2020).

### Gifts of Equity

Enter a gift of equity in Section VI A.

A gift of equity must meet the gift of equity requirements defined in B3-4.3-05, Gifts of Equity (10/07/2020).

### Net Equity (From Properties Pending Sale)

When full REO data is entered, DU automatically calculates the estimated net equity from properties marked Pending Sale in Section VI R using the following formula:

$((\text{Present Market Value} \times 90\%) - \text{Amount of Mtgs. \& Liens})$

However, because full REO data is not required, the lender can calculate the net equity outside of DU and enter the amount (positive or negative) as Net Equity in Section VI A.

If net equity is calculated from data in Section VI R and is also entered in Section VI A, DU will use the amount from Section VI A.

If a bridge loan is obtained, the amount of the bridge loan should be subtracted from the net proceeds.

When the net equity is positive, DU will add the amount to the funds available for closing. When the net equity is negative, DU will subtract the amount from the funds available for closing.

### Net Worth of Business

When net worth of business is entered in Section VI A, DU does not consider it liquid. If the borrower is using proceeds from the sale of his or her business, the net proceeds should be entered in a depository account, such as a checking or savings account.

### Other Liquid Asset

Enter the value of personal assets that will be converted to a liquid asset (or sold) prior to closing. For example, enter as Other Liquid Asset the net cash value of life insurance, automobiles, or other personal assets that will be sold, or the amount of pending tax refunds that will be received prior to closing. A verification message will require evidence of the value of the asset and confirmation that the asset was converted to cash.

**Note:** Some loan origination systems may not provide an asset type for other liquid assets, or the entry may not map correctly to DU. In such cases, assets that would otherwise have been entered as Other Liquid Asset should be included in a depository account, such as a checking or savings account, if the assets will be converted to cash prior to closing. Appropriate documentation should be included in the loan file.

### Proceeds From Sold Properties

Proceeds from properties that have already been sold should be included in a depository account, such as a checking or savings account.

### Secured Borrowed Funds

Borrowers can borrow against an asset they own, such as a 401(k) account or real estate, according to the requirements of B3-6-05, Monthly Debt Obligations (02/05/2020). The amount of the secured loan should be entered as Secured Borrowed Funds in Section VI A. The secured loan amount should be subtracted from the market value of the actual asset, and the net asset value should be entered in the appropriate field in Section VI A. For example, if the borrower has a vested value, less taxes and penalties, of \$30,000 in a 401(k) account and borrows \$10,000 against the 401(k), enter \$10,000 as secured borrowed funds and enter \$20,000 as retirement funds.

Loans that are secured against a liquid asset owned by the borrower (such as a 401(k) or mutual fund) do not have to be entered as liabilities in Section VI Liabilities if the appropriate documentation is provided.

Loans that are secured against real estate, or any other non-liquid asset, must be entered as liabilities in Section VI Liabilities.

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2016-09	December 6, 2016
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement SEL-2010-01	March 2, 2010

## B3-4.4-02, Requirements for Certain Assets in DU (12/16/2020)

### Introduction

This topic contains information about certain asset policies in DU, including:

- Asset Verification Documentation
- Depository Assets
- Bridge Loan
- Cash Deposit on Sales Contract (Earnest Money)
- Gifts and Grants
- Gifts of Equity
- Net Equity from Properties Pending Sale
- Proceeds from Sold Properties
- Net Worth of Business
- Other Liquid Assets
- Secured Borrowed Funds

### Asset Verification Documentation

DU indicates the minimum verification documentation requirements necessary for the lender to process the loan application. This level of documentation may not be adequate for every borrower and every situation. The lender must determine whether additional documentation is warranted.

### Depository Assets

For depository assets (checking and savings accounts, money market funds, and certificates of deposit), DU will require two consecutive monthly bank statements (60 days of account activity).

Monthly bank statements must be dated within 45 days of the initial loan application date.

Quarterly bank statements must be dated within 90 days of the initial loan application date, and the lender must confirm that the funds in the account have not been transferred to another asset account that is verified with more current documentation.

A *Verification of Deposit* (Form 1006 or Form 1006(S)) can be obtained in place of bank statements.

When DU validates assets, DU issues a message indicating the acceptable documentation. Compliance with the DU message satisfies the requirement for documenting assets. This documentation may differ from the requirements described above. See B3-2-02, DU Validation Service (10/07/2020)

### Bridge Loan

Enter the amount of a bridge (or swing) loan in the asset section of the loan application. Do not include the amount of the bridge loan in any other liquid asset. (For example, do not enter the amount of the loan both as a bridge loan and in a checking account, even if the loan funds have been deposited.)

Bridge loans should also be considered in the net equity calculation for properties that are pending sale. (In other words, the amount of the bridge loan should be subtracted from the net proceeds to avoid counting this asset twice.)

See B3-4.3-14, Bridge/Swing Loans (04/01/2009) for additional information.

**Note:** It may also be necessary to enter the bridge loan and corresponding monthly payment as a recurring liability in the liabilities section of the loan application. See the bridge loan liability discussion in B3-6-05, Monthly Debt Obligations (12/16/2020).

### Cash Deposit on Sales Contract (Earnest Money)

See B3-4.3-09, Earnest Money Deposit (08/21/2012), for documentation requirements.

#### Form 1003 7/05 (rev. 6/09)

When cash deposit on sales contract (earnest money) is entered in Section VI Assets, DU does not consider it liquid. Therefore, in order to give the borrower credit for earnest money that is not already reflected in a liquid account, the lender must enter the earnest money amount as follows:

- If the earnest money check has not cleared the borrower's bank account, the amount can be included in a depository account, such as a checking or savings account.
- If the earnest money check has cleared the borrower's bank account, the amount can be entered as Other Credit in Section VII, where it is assumed to be verified.

Do not enter the amount in both places.

#### Form 1003 1/2021

Earnest money is treated as a credit to the transaction and will reduce the borrower's required funds to close as reflected in L4. Qualifying the Borrower - Minimum Required Funds or Cash Back. The earnest money check is assumed to have cleared the borrower's bank account and must not be reflected in the balance of an asset account.

### Gifts and Grants

Gifts or donations from entities (grants) are permitted and documented in accordance with B3-4.3-04, Personal Gifts (10/07/2020), and B3-4.3-06, Grants and Lender Contributions (12/16/2020). The entry of gifts and grants on the loan application is as follows:

#### Form 1003 7/05 (rev. 6/09)

- When a gift is entered in Section VI Assets as a gift, the funds are included in available funds. It is important that the gift amount is identified separately as a gift even if the funds have already been deposited in a liquid asset account owned by the borrower (such as a

checking or savings account). The balance of the liquid asset account entered in the loan application must be adjusted accordingly to prevent duplicate entry of funds. For example, if the borrower's verified checking account reflects a balance of \$15,000, and \$5,000 of that amount was from a gift, the checking account balance should be adjusted to reflect \$10,000, and the \$5,000 should be entered separately as a gift.

- When a gift is entered in Section II as a source of down payment, the funds are not included in the available funds.

**Note:** Gift funds are considered liquid only when the funds are entered as Gift in Section VI Asset. Grants are entered as a gift.

Some loan origination systems (LOS) may not provide a "gift" data entry option, or the gift entry may not map correctly to DU. (For example, the LOS may identify the gift as a checking account when the data is transmitted to DU.) The lender must ensure that gift information has been properly identified in DU.

#### **Form 1003 1/2021**

Gifts and grants are entered in Section 4d and identified as being deposited or not deposited. Gifts and grants that are deposited have been received by the borrower and the value should be included in another asset account. The amount of the gift or grant is not included in available funds.

Gifts and grants that are not deposited are not included in another asset account. The amount of the gift is included in available funds.

#### **Gifts of Equity**

Enter a gift of equity in the loan application.

A gift of equity must meet the gift of equity requirements defined in B3-4.3-05, Gifts of Equity (10/07/2020).

#### **Net Equity from Properties Pending Sale**

See B3-4.3-10, Anticipated Sales Proceeds (02/23/2016), for additional information.

#### **Form 1003 7/05 (rev. 6/09)**

When full REO data is entered, DU automatically calculates the estimated net equity from properties marked Pending Sale in Section VI R using the following formula:

$((\text{Present Market Value} \times 90\%) - \text{Amount of Mtgs. \& Liens})$

However, because full REO data is not required in the online loan application, the lender can calculate the net equity outside of DU and enter the amount (positive or negative) as Net Equity in Section VI A.

If net equity is calculated from data in Section VI R and is also entered in Section VI A, DU will use the amount from Section VI A.

If a bridge loan is obtained, the amount of the bridge loan is subtracted from the net proceeds (in the Amount of Mtgs & Liens in the REO or when Net Equity is calculated by the lender).

When the net equity is positive, DU will add the amount to the funds available for closing. When the net equity is negative, DU will subtract the amount from the funds available for closing.

#### **Form 1003 1/2021**

The lender must calculate the net equity from a property marked Pending Sale in the REO section outside of DU. The amount is entered as the asset Proceeds from Real Estate Property to be Sold on or Before Closing.

If a bridge loan is obtained, the amount of the bridge loan is entered as an asset and must be subtracted from net equity before entry in the loan application.

When the net equity is positive, DU will add the amount to the funds available for closing. When the net equity is negative, DU will subtract the amount from the funds available for closing.

#### **Proceeds from Sold Properties**

Proceeds from properties that have already been sold must be included in a depository account, such as a checking or savings account.

#### **Net Worth of Business**

#### **Form 1003 7/05 (rev. 6/09)**

When net worth of business is entered in Section VI A, DU does not consider it liquid. If the borrower is using proceeds from the sale of his or her business, the net proceeds should be entered in a depository account, such as a checking or savings account.

#### **Other Liquid Assets**

#### **Form 1003 7/05 (rev. 6/09)**

Enter the value of personal assets that will be converted to a liquid asset (or sold) prior to closing. For example, enter as Other Liquid Asset the net cash value of life insurance, automobiles, or other personal assets that will be sold, or the amount of pending tax refunds that will be received prior to closing. A verification message will require evidence of the value of the asset and confirmation that the asset was converted to cash.

**Note:** Some loan origination systems may not provide an asset type for other liquid assets, or the entry may not map correctly to DU. In such cases, assets that would otherwise have been entered as Other Liquid Asset should be included in a depository account, such as a checking or savings account, if the assets will be converted to cash prior to closing. Appropriate documentation must be included in the loan file.

#### **Form 1003 1/2021**

Enter the value of personal assets that will be converted to a liquid asset (or sold) prior to closing as the asset type Proceeds from Sale of Non-Real Estate Asset. (See B3-4.3-18, Sale of Personal Assets (12/16/2020), for additional information.) Life insurance that will be used for the transaction is entered as Cash Value of Life Insurance. An Other Asset (liquid) may be entered for other types of assets that will be used for the transaction, such as pending tax refunds that will be received prior to closing.

A verification message will require evidence of the value of the asset and confirmation that the asset was converted to cash.

## Secured Borrowed Funds

Borrowers can borrow against an asset they own, such as a 401(k) account or real estate, according to the requirements of B3-6-05, Monthly Debt Obligations (12/16/2020). The amount of the secured loan should be entered as Secured Borrowed Funds in the asset section of the loan application. The secured loan amount should be subtracted from the market value of the actual asset, and the net asset value should be entered. For example, if the borrower has a vested value, less taxes and penalties, of \$30,000 in a 401(k) account and borrows \$10,000 against the 401(k), enter \$10,000 as secured borrowed funds and enter \$20,000 as retirement funds.

A loan that is secured against a liquid asset owned by the borrower (such as a 401(k) or mutual fund) does not have to be entered as a liability in the loan application if the appropriate documentation is provided.

Loans that are secured against real estate, or any other non-liquid asset, must be entered as the applicable liability (for example, as a mortgage).

## Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2016-09	December 6, 2016
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement SEL-2010-01	March 2, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Credit Assessment

## Credit Assessment

### Introduction

This chapter describes credit assessment for qualifying, underwriting, and documentation purposes.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.1, Credit Scores > B3-5.1-01, General Requirements for Credit Scores (08/05/2020)

REVISION HISTORY **08/07/2019**

REVISION NUMBER: 08072019      DATE: 08/07/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-5.1-01, General Requirements for Credit Scores (08/07/2019)

#### Introduction

This topic describes Fannie Mae's requirements for borrower credit scores, including:

- Credit Score Versions
- Minimum Credit Score Requirements
- Exceptions to the Minimum Credit Score Requirement
- DU Credit Score Requirements
- Loan-Level Price Adjustments Based on Credit Score

#### Credit Score Versions

Credit scores are required for most mortgage loans purchased or securitized by Fannie Mae. The classic FICO credit score is produced from software developed by Fair Isaac Corporation and is available from the three major credit repositories. Fannie Mae requires the following versions of the classic FICO score for both DU and manually underwritten mortgage loans:

- Equifax Beacon® 5.0;
- Experian®/Fair Isaac Risk Model V2SM; and
- TransUnion FICO® Risk Score, Classic 04.

The lender must request these FICO credit scores for each borrower from each of the three major credit repositories when they order the three in-file merged credit report. If the borrower's credit file includes complete and accurate information to ensure the validity of the credit score, the lender does not need to further evaluate the borrower's creditworthiness.

**Note:** The credit report will indicate if a credit score could not be produced due to insufficient credit. The credit report must be maintained in the mortgage loan file, whether the report includes traditional credit and a credit score or indicates that a credit score could not be produced due to insufficient or frozen credit.

#### Minimum Credit Score Requirements

Fannie Mae's minimum credit score requirements are published in the *Eligibility Matrix* and are based on the representative credit score for the transaction and the highest of the LTV, CLTV, or HCLTV ratios, as applicable. See B3-5.1-02, Determining the Representative Credit Score for a Mortgage Loan (08/30/2016) for additional information. The following requirements apply:

Transaction Type	Minimum Representative Credit Score
Manually underwritten mortgage loans	Per the <i>Eligibility Matrix</i> , but in no case will credit scores be lower than

	620 — fixed-rate loans 640 — ARMs
DU loan casefiles	DU performs its own analysis of the credit report data, but in no case will credit scores be lower than 620 — fixed-rate loans and ARMs
Mortgage loans insured or guaranteed by a federal government agency (HUD, FHA, VA, and RD)	620
Loans delivered pursuant to any variance contained in the lender's Master Agreement	Higher of 620 or the minimum credit score required by the variance

### Exceptions to the Minimum Credit Score Requirement

Certain transactions are not subject to the minimum credit score requirement, including:

- loans where no borrower has a credit score (see Section B3-5.4, Nontraditional Credit History);
- manually underwritten HomeReady mortgage loans that include a borrower with a low credit score (see B5-6-03, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019)); and
- high LTV refinance loans, except for those loans underwritten using the Alternative Qualification Path.

### DU Credit Score Requirements

Credit scores are not an integral part of DU's risk assessment because DU performs its own analysis of the credit report data. However, lenders must request credit scores for each borrower from each of the three credit repositories when they order the three in-file merged credit report, described in B3-5.2-01, Requirements for Credit Reports (08/29/2017). If one or two of the credit repositories do not contain any credit information for the borrowers who have traditional credit, the credit report is still acceptable as long as

- credit data is available from one repository,
- a credit score is obtained from that repository, and
- the lender requested a three in-file merged report.

**Note:** When a loan casefile is submitted to DU for a borrower with a credit score, but only medical tradelines are reported on the credit report, the loan casefile will receive an Out of Scope recommendation. The lender can manually underwrite the loan casefile in accordance with the *Selling Guide*.

If the transaction does not meet the above requirements, refer to Section B3-5.4, Nontraditional Credit History, for underwriting and eligibility requirements for DU loans in which one or more borrowers do not have a credit score.

### Frozen Credit Requirements

If the borrower's credit information is frozen at one of the credit repositories for borrowers who have traditional credit, the credit report is still acceptable as long as

- credit data is available from two repositories,
- a credit score is obtained from at least one of those two repositories, and
- the lender requested a three in-file merged report.

Loans for borrowers with credit data frozen at two or more of the credit repositories will not be eligible whether underwritten manually or in DU.

### Loan-Level Price Adjustments Based on Credit Score

Loan-level price adjustments (LLPAs) are assessed based on the "representative" credit score for the loan, in addition to other eligibility and loan features. See the *Loan-Level Price Adjustment (LLPA) Matrix* for additional information about LLPAs, including information about how LLPAs are assessed for loans that include borrowers without a credit score.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2015-02	February 24, 2015
Announcement SEL-2013-06	August 20, 2013
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-06	June 26, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2011-12	November 15, 2011
Announcement SEL-2010-06	April 30, 2010

Announcement –2009–37	December 30, 2009
Announcement –2009–32	October 30, 2009
Announcement –2009–29	September 22, 2009
Announcement 09-08R	June 8, 2009
Announcement –2009–12	May 4, 2009
Announcement –2009–04	March 4, 2009

### B3-5.1-01, General Requirements for Credit Scores (08/05/2020)

#### Introduction

This topic describes Fannie Mae’s requirements for borrower credit scores, including:

- Credit Score Versions
- Minimum Credit Score Requirements
- Exceptions to the Minimum Credit Score Requirement
- DU Credit Score Requirements
- Loan-Level Price Adjustments Based on Credit Score

#### Credit Score Versions

Credit scores are required for most mortgage loans purchased or securitized by Fannie Mae. The classic FICO credit score is produced from software developed by Fair Isaac Corporation and is available from the three major credit repositories. Fannie Mae requires the following versions of the classic FICO score for both DU and manually underwritten mortgage loans:

- Equifax Beacon® 5.0;
- Experian®/Fair Isaac Risk Model V2SM; and
- TransUnion FICO® Risk Score, Classic 04.

The lender must request these FICO credit scores for each borrower from each of the three major credit repositories when they order the three in-file merged credit report. If the borrower’s credit file includes complete and accurate information to ensure the validity of the credit score, the lender does not need to further evaluate the borrower’s creditworthiness.

**Note:** The credit report will indicate if a credit score could not be produced due to insufficient credit. The credit report must be maintained in the mortgage loan file, whether the report includes traditional credit and a credit score or indicates that a credit score could not be produced due to insufficient or frozen credit.

#### Minimum Credit Score Requirements

Fannie Mae’s minimum credit score requirements are published in the *Eligibility Matrix* and are based on the representative credit score for the transaction and the highest of the LTV, CLTV, or HCLTV ratios, as applicable. See B3-5.1-02, Determining the Representative Credit Score for a Mortgage Loan (08/30/2016) for additional information. The following requirements apply:

Transaction Type	Minimum Representative Credit Score
Manually underwritten mortgage loans	Per the <i>Eligibility Matrix</i> , but in no case will credit scores be lower than 620 — fixed-rate loans 640 — ARMs
DU loan casefiles	DU performs its own analysis of the credit report data, but in no case will credit scores be lower than 620 — fixed-rate loans and ARMs
Mortgage loans insured or guaranteed by a federal government agency (HUD, FHA, VA, and RD)	620
Loans delivered pursuant to any variance contained in the Lender Contract	Higher of 620 or the minimum credit score required by the variance

#### Exceptions to the Minimum Credit Score Requirement

Certain transactions are not subject to the minimum credit score requirement, including:

- loans where no borrower has a credit score (see Section B3–5.4, Nontraditional Credit History);
- manually underwritten HomeReady mortgage loans that include a borrower with a low credit score (see B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019)); and
- high LTV refinance loans, except for those loans underwritten using the Alternative Qualification Path.

#### DU Credit Score Requirements

Credit scores are not an integral part of DU’s risk assessment because DU performs its own analysis of the credit report data. However, lenders must request credit scores for each borrower from each of the three credit repositories when they order the three in-file merged credit report, described in B3-5.2-01, Requirements for Credit Reports (08/29/2017). If one or two of the credit repositories do not contain any credit information for the borrowers who have traditional credit, the credit report is still acceptable as long as

- credit data is available from one repository,
- a credit score is obtained from that repository, and
- the lender requested a three in-file merged report.

**Note:** When a loan casefile is submitted to DU for a borrower with a credit score, but only medical tradelines are reported on the credit report, the loan casefile will receive an Out of Scope recommendation. The lender can manually underwrite the loan casefile in accordance with the *Selling Guide*.

If the transaction does not meet the above requirements, refer to Section B3-5.4, Nontraditional Credit History, for underwriting and eligibility requirements for DU loans in which one or more borrowers do not have a credit score.

#### Frozen Credit Requirements

If the borrower's credit information is frozen at one of the credit repositories for borrowers who have traditional credit, the credit report is still acceptable as long as

- credit data is available from two repositories,
- a credit score is obtained from at least one of those two repositories, and
- the lender requested a three in-file merged report.

Loans for borrowers with credit data frozen at two or more of the credit repositories will not be eligible whether underwritten manually or in DU.

#### Loan-Level Price Adjustments Based on Credit Score

Loan-level price adjustments (LLPAs) are assessed based on the "representative" credit score for the loan, in addition to other eligibility and loan features. See the *Loan-Level Price Adjustment (LLPA) Matrix* for additional information about LLPAs, including information about how LLPAs are assessed for loans that include borrowers without a credit score.

#### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-04	August 05, 2020
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2015-02	February 24, 2015
Announcement SEL-2013-06	August 20, 2013
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-06	June 26, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2011-12	November 15, 2011
Announcement SEL-2010-06	April 30, 2010
Announcement -2009-37	December 30, 2009
Announcement -2009-32	October 30, 2009
Announcement -2009-29	September 22, 2009
Announcement 09-08R	June 8, 2009
Announcement -2009-12	May 4, 2009
Announcement -2009-04	March 4, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.1, Credit Scores > B3-5.1-02, Determining the Representative Credit Score for a Mortgage Loan (08/30/2016)

#### B3-5.1-02, Determining the Representative Credit Score for a Mortgage Loan (08/30/2016)

##### Introduction

This topic contains requirements associated with determining the representative credit score, including:

- Representative Credit Score
- Foreign Credit Reports and Credit Scores

##### 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	Fannie Mae recommends obtaining at least two credit scores for each borrower.
2	Select a single applicable score for underwriting each borrower.

	<ul style="list-style-type: none"> <li>• When two credit scores are obtained, choose the lower score.</li> <li>• 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: 700, 680, 680 = 680; 700, 700, 680 = 700)</li> </ul>
3	<p>If there is only one borrower, the single applicable score used to underwrite that borrower is the representative credit score for the mortgage.</p> <p>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. If there is a borrower on the loan who does not have a credit score, determine the representative credit score for the mortgage based on the credit scores of the other borrowers on the mortgage.</p>

### Foreign Credit Reports and Credit Scores

With the exception of loan casefiles underwritten through DU, Fannie Mae permits the lender to use a credit report from a foreign country to document a borrower's credit history. (See B3-5.2-01, Requirements for Credit Reports (08/29/2017).) If a credit score is provided with the foreign credit report it cannot be used to establish eligibility unless the credit score is the classic FICO, as required by B3-5.1-01, General Requirements for Credit Scores (08/05/2020). In addition, the lender must not deliver the foreign credit score to Fannie Mae and it cannot be relied upon to establish eligibility (unless the credit score is the classic FICO). See Section B3-5.4, Nontraditional Credit History, for requirements that apply when a loan includes a borrower without an acceptable credit score.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2012-06	June 26, 2012
Announcement -2009-32	October 30, 2009
Announcement -2009-12	May 4, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.2, Credit Reports > B3-5.2-01, Requirements for Credit Reports (08/29/2017)

### B3-5.2-01, Requirements for Credit Reports (08/29/2017)

#### Introduction

This topic describes requirements for credit reports, including:

- Overview
- General Requirements
- Public Records Information
- Acceptable and Unacceptable Changes
- Required Creditor Information
- Format for Reporting Payment History
- Inquiries
- Unreported Debts
- Assessing Borrower Credit Management Skills
- Credit Report Requirements in Desktop Underwriter
- Credit Score Requirements

#### Overview

The lender must obtain a credit report for each borrower on the loan application who has an individual credit record. The credit report must be based on data provided by the national credit repositories. Acceptable credit report formats are described in B3-5.2-02, Types of Credit Reports (12/19/2017). For credit report requirements in DU see below.

A nontraditional mortgage credit report or other form of alternative credit verification may be used if the borrower

- does not have sufficient credit to enable the development of a credit score, or
- does not use the type of credit that is reported to credit repositories.

See Section B3-5.4, Nontraditional Credit History for additional information.

#### General Requirements

Credit reports must meet the following general requirements:

- The report must include both credit and public record information for each locality in which the borrower has resided during the most recent two-year period.

If the lender relies on credit reports from foreign countries to document borrower credit histories, the credit report must meet the requirements and standards for domestic reports, and must be completed in English or include an English translation. (See B3-5.1-02, Determining the Representative Credit Score for a Mortgage Loan (08/30/2016) for information about credit scores in foreign credit reports.)

- The report must include all discovered credit and legal information that is not considered obsolete under the Fair Credit Reporting Act. Although the Fair Credit Reporting Act currently specifies that credit information is not considered obsolete until after seven years, and

bankruptcy information after ten years, Fannie Mae requires only a seven-year history to be reviewed for all credit and public record information.

- The report must be an original report, with no erasures, white-outs, or alterations. An automated credit report or one that is transmitted by fax is considered to be an "original" report.
- The report must include the full name, address, and telephone number of the credit reporting agency, as well as the names of the national repositories that the agency used to provide information for the report.
- The credit reporting agency must make responsive statements about all items on the credit report—indicating "unable to verify" or "employer refused to verify," when appropriate.

### **Public Records Information**

The report must include all available public records information, identify the sources of the public records information, and disclose whether any judgments, foreclosures, tax liens, or bankruptcies were discovered (with these adverse items reported in accordance with the Fair Credit Reporting Act and to the extent reported by consumer reporting agencies participating in the National Consumer Assistance Plan).

Public records information must be obtained from two sources, which may include any combination of the following:

- national repositories of accumulated credit records,
- direct searches of court records by employees of the lender or the consumer reporting agency, or
- record searches made by other public records search firms.

### **Acceptable and Unacceptable Changes**

Collected credit report information should not be changed. However, it is permissible to delete duplicate information, translate codes to plain language, and make appropriate adjustments to resolve conflicting information to ensure the clarity of the report.

The following types of changes are unacceptable:

- deleting tradelines that pertain to a borrower's bankruptcy,
- adding a payment amount to a creditor's tradeline when the creditor does not require a payment, or
- restricting information collection to a shorter time period than Fannie Mae requires.

Credit repositories should only change the information called to its attention by a creditor or a party that is not associated with either the real estate sale or purchase transaction or the mortgage financing.

### **Required Creditor Information**

For each debt listed, the report must provide:

- the creditor's name,
- the date the account was opened,
- the amount of the highest credit,
- the current status of the account,
- the required payment amount,
- the unpaid balance, and
- a payment history.

The report must indicate the dates that accounts were last updated with the creditors. Each account with a balance must have been checked with the creditor within 90 days of the date of the credit report.

### **Format for Reporting Payment History**

All data must be presented in a format that is easy to read and that is understandable without the need for code translations.

The report must list the historical status of each account. This status must be presented in a "number of times past due" format and include the dates of the delinquencies.

The preferred format is "0 x 30, 0 x 60, 0 x 90 days" late. The following formats are also acceptable:

- "R1, R2, R3, ...," if it also gives historical negative ratings, such as "was R3 in 6/05."
- a consecutive numbering sequence, such as "0001000 ...," provided the meaning is clear from the report.

Statements such as "current," "satisfactory," or "as agreed" are not satisfactory by themselves.

### **Inquiries**

The report must list all inquiries that were made in the previous 90 days.

### **Unreported Debts**

If the credit report does not include a reference for each significant open debt on the application, the lender must obtain a separate written verification for each unreported debt. The lender also needs to verify separately accounts listed as "will rate by mail only" or "need written authorization."

### **Assessing Borrower Credit Management Skills**

The borrower's credit management skills can be assessed by analyzing repayment patterns, credit utilization, and level of experience in using credit.

### **Credit Report Requirements in Desktop Underwriter**

Lenders are required to request a three in-file merged credit report from one of the credit information providers listed on Fannie Mae's website. The credit report used by DU in the final loan casefile submission must be maintained in the mortgage loan file. A DU observation message will identify all of the credit reports evaluated by DU during the loan submission. The version of the credit report received by DU must be one that supports trended credit data. Trended credit data is expanded information on a borrower's credit history at a tradeline level

on several monthly factors, including: amount owed, minimum payment, and payment made.

**Note:** The borrower's present address must be within the U.S., U.S. territories, or an APO, FPO, or DPO military address located within the U.S. in order to obtain a credit report that is compatible with DU loan casefile requirements. Borrowers with foreign credit reports must be manually underwritten.

### Credit Score Requirements

See B3-5.1-01, General Requirements for Credit Scores (08/05/2020), for additional information about credit report requirements related to credit scores.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2017-07	August 29, 2017
Announcement SEL-2016-09	December 06, 2016
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2016-04	May 31, 2016
Announcement -2009-32	October 30, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.2, Credit Reports > B3-5.2-02, Types of Credit Reports (12/19/2017)

### B3-5.2-02, Types of Credit Reports (12/19/2017)

#### Introduction

This topic contains information on the types of credit reports that are accepted by Fannie Mae, including:

- In-File Credit Reports
- Automated Merged Credit Reports
- Residential Mortgage Credit Reports

#### In-File Credit Reports

An in-file credit report provides credit and public record information obtained from one or more credit repositories. The report contains "as is" information, which typically has not been updated or re-verified as a result of the credit inquiry.

The report must meet the following requirements:

- The report should include all information from three different credit repositories, or two repositories, if:
  - that is the extent of the data available for the borrower, or
  - the borrower's credit information is frozen at one credit repository.
- If only one in-file credit report is available for a borrower, this is acceptable if the lender is able to obtain a credit score for the borrower and the lender requested information from three credit repositories.
- If the report does not include a reference for each significant debt reported by the borrower on the loan application, the lender must obtain a separate written verification for each unreported (or unrated) debt.
- If the report lists accounts that were not checked with the creditor within 90 days of the date of the in-file report, the lender must obtain an updated credit report or a separate written verification for those accounts.

#### Automated Merged Credit Reports

An automated merged credit report combines the in-file credit reports from multiple repositories into a single report. A joint merged credit report includes all credit repository credit data on more than one individual applicant.

The report must meet the following requirements:

- The report must include all information from three different credit repositories, or two repositories, if:
  - that is the extent of the data available for the borrower, or
  - the borrower's credit information is frozen at one credit repository.
- If information from only one credit repository is available, this is acceptable if the lender is able to obtain a credit score for the borrower and the lender requested information from three different credit repositories.
- The report cannot be provided by a credit reporting agency that is affiliated with the lender in any way.
- The report must include all information reported for the borrower from the in-file credit reports.
- The report must identify the repositories that were used for the in-file credit reports.
- The report does not have to repeat duplicate information that is in in-file credit reports. However, if duplicate information is not exactly the same on each report, the automated merged report must either repeat the information or include the most derogatory of the duplicate information that pertains to payment history and/or current payment status.

#### Residential Mortgage Credit Reports

A residential mortgage credit report is a detailed account of the borrower's credit, employment, and residency history, as well as public records information.

The report must meet the following requirements:

- The credit reporting agency must contact at least two national repositories of accumulated credit records for each locality in which the

borrower has lived during the most recent two-year period.

- All information must be obtained from, or verified by, sources other than the borrower. When co-borrowers have individually obtained credit, separate repository inquiries are necessary, although the results of both reports may be combined in one report, as long as the report clearly indicates that this has been done.
- The credit reporting agency must verify, either in writing or by telephone, the borrower's current employment and income (if it can be obtained). If the borrower has changed jobs in the past two years, the credit report also must mention the borrower's previous employment and income.
- The report must include a positive statement that the employment was verified, the date of the verification, and the name of the individual who confirmed the employment. If this information was not obtained by an employer interview, the credit reporting agency must indicate why that was not done.
- The report must include the name of the party who ordered the report. If another party paid for the report, the credit report must provide that party's name, unless the lender ordered the report and the billed party has a documented agent or corporate relationship with the lender.
- The original report must be delivered to the office of the party who requested it, using any means acceptable under the Fair Credit Reporting Act or other similar regulations, such as sending it through the U.S. postal system, by messenger, over a fax machine, or through other automated means.
- The report must include a certification that it meets the standards for a residential mortgage credit report.

When the credit reporting agency has incomplete information, discovers that the borrower might not have disclosed all information that should be found in the public records, or obtains other information that indicates the possible existence of undisclosed credit records, the credit reporting agency must interview the borrower(s) to obtain additional information that is needed to provide an accurate report or perform additional research to verify whether the purported undisclosed records actually exist.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2010-13	September 20, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.2, Credit Reports > B3-5.2-03, Accuracy of Credit Information in a Credit Report (07/25/2017)

### B3-5.2-03, Accuracy of Credit Information in a Credit Report (07/25/2017)

#### Introduction

This topic contains information on the following:

- Accuracy of Credit Information in a Credit Report
- Disputed Tradelines

#### Accuracy of Credit Information in a Credit Report

For all mortgage loans (including DU loan casefiles and manually underwritten loans), the lender is responsible for reviewing the credit report, as well as all credit information, to determine that the credit report meets Fannie Mae's requirements and that the data evaluated by DU was accurate.

If a borrower indicates that any significant information in the credit file is inaccurate—such as reported accounts that do not belong to the borrower or derogatory information that is reported in error—the lender should carefully review the credit information with the borrower, then request the credit reporting company that provided the information to confirm its accuracy.

#### Disputed Tradelines

##### Manually Underwritten Loans

If the borrower has disputed information in their credit file, and the credit reporting company confirms that the disputed information is incorrect or incomplete and underwriting the loan needs to be completed before the credit files can be corrected, the lender cannot use the credit score(s) when manually underwriting the loan. Instead, the credit risk assessment must be based on a review of the borrower's traditional credit history.

If there are multiple disputed tradelines or a dispute on a mortgage tradeline, the lender should obtain correspondence directly from the borrower indicating the reason for the dispute. The aspect of the tradeline—such as balance and payment history—that is being disputed is of particular interest when considering the impact to the borrower's overall credit profile.

The lender is responsible for determining whether the borrower's explanation is reasonable and/or whether additional documentation (such as canceled checks) is necessary to disprove the adverse information. Lenders are not required to investigate disputed medical tradelines.

##### DU Loans

For loan casefiles underwritten through DU, DU will indicate if the lender is required to investigate the disputed account to determine if the account belongs to the borrower and confirm the accuracy and completeness of the information reported on the account.

See B3-2-09, Erroneous Credit Report Data (01/27/2015); B3-2-10, Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report (12/04/2019); and B3-5.3-09, DU Credit Report Analysis (12/04/2019) for additional information.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2017-06	July 25, 2017

Announcement SEL-2015-03	March 31, 2015
Announcement SEL-2014-11	August 26, 2014
Announcement -2009-32	October 30, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-01, Number and Age of Accounts (04/01/2009)

### **B3-5.3-01, Number and Age of Accounts (04/01/2009)**

#### **Introduction**

This topic contains information on the number and age of accounts.

#### **Number and Age of Accounts**

The lender must review the borrower's credit report to determine whether he or she has an older established credit history or a newly established credit history, and whether there are a significant number of recently opened accounts or a mix of new accounts and older accounts.

Credit histories that include older, established accounts generally represent lower credit risk. However, an older, established credit history that includes a significant number of recently opened accounts may indicate that the borrower is overextended, and thus will represent a higher credit risk.

A newly established credit history does not automatically represent a higher credit risk, since making payments as agreed on newly opened accounts represents less of a risk than not making payments as agreed on older, established accounts.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-02, Payment History (04/01/2009)

### **B3-5.3-02, Payment History (04/01/2009)**

#### **Introduction**

This topic contains information on the borrower's payment history.

#### **Payment History**

The lender must review the borrower's credit report to determine the current status of each credit account (including mortgage accounts), the timeliness of payments, and the frequency, recency, and severity of any delinquent payments.

- Credit histories that include no late payments, collection or charged-off accounts, foreclosures, deeds-in-lieu, bankruptcies, or other public records information represent a lower credit risk.
- Credit histories that include recent late payments represent a higher credit risk than those with late payments that occurred more than 24 months ago. When there are payments that were 30, 60, or 90 days (or longer) past due, the lender must determine whether the late payments represent isolated incidences or frequent occurrences. Delinquent payments must be evaluated in the context of the borrower's overall credit history, including the number and age of accounts, credit utilization, and recent attempts to obtain new credit. For example, a credit history that includes delinquent payments along with recent inquiries and a high balances-to-limits ratio indicates a high credit risk.
- Credit histories that include foreclosures, deeds-in-lieu, and public records information (such as bankruptcies, judgments, and liens) represent a higher credit risk. The greater the number of such incidences and the more recently they occurred, the higher the credit risk.

For information about mortgage payment history, see B3-5.3-03, Previous Mortgage Payment History (07/25/2017).

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-03, Previous Mortgage Payment History (07/25/2017)

### **B3-5.3-03, Previous Mortgage Payment History (07/25/2017)**

#### **Introduction**

This topic contains information on previous mortgage payment history requirements, including:

- Documenting Previous Mortgage History
- Standard Mortgage Verifications from Servicers
- Existing Mortgage Payment Requirements
- Excessive Mortgage Delinquency

#### **Documenting Previous Mortgage History**

The lender must review the borrower's credit report to determine the status of all mortgage accounts. If a borrower had previous mortgages, the lender does not have to independently verify the mortgage's payment history provided the credit report includes a reference to the mortgage (or mortgages) and reflects 12 months of the most recent payment activity.

If adequate mortgage payment history is not included in the borrower's credit report, the lender must use the following to verify the borrower's payment history on a previous mortgage(s):

- a standard mortgage verification;
- loan payment history from the servicer;
- the borrower's canceled checks for the last 12 months; or
- the borrower's year-end mortgage account statement, provided the statement includes a payment receipt history, and, if applicable, canceled checks for the months elapsed since the year-end mortgage account statement was issued.

#### **Standard Mortgage Verifications from Servicers**

When a lender relies on standard mortgage verifications from servicers or holders, it must ensure that the verifications include:

- the unpaid principal balance of the mortgage and monthly payment amount;
- the present status of the mortgage, such as current, 30 days' delinquent, etc.; and
- the borrower's payment history.

When a servicer fails to provide all of the requested information, the lender must rely on information provided through the borrower's canceled checks. The checks must:

- be legible,
- identify the mortgage servicer or mortgage holder as the payee,
- indicate that the servicer or holder endorsed the check for deposit, and
- indicate the date the servicer or holder deposited the check.

### Existing Mortgage Payment Requirements

On the date of the loan application, the borrower's existing mortgage must be current, which means that no more than 45 days may have elapsed since the last paid installment date.

### Excessive Mortgage Delinquency

The lender must review the borrower's credit history to determine previous mortgage delinquency, severity (e.g., 30, 60, or 90 days), and recency of the delinquency. Loans with excessive prior mortgage delinquencies are not eligible for delivery to Fannie Mae. Excessive prior mortgage delinquency is defined as any mortgage tradeline that has one or more 60-, 90-, 120-, or 150-day delinquency reported within the 12 months prior to the credit report date. See B3-5.3-02, Payment History (04/01/2009), and B3-5.3-07, Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (08/07/2019) for additional information.

**Note:** For purposes of complying with the guidelines in this topic, timeshare accounts identified as mortgage tradelines are not required to meet the requirements described above, and are considered to be installment accounts.

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2017-06	July 25, 2017

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-04, Inquiries: Recent Attempts to Obtain New Credit (04/01/2009)

### B3-5.3-04, Inquiries: Recent Attempts to Obtain New Credit (04/01/2009)

#### Introduction

This topic contains information on inquiries: recent attempts to obtain new credit.

#### Inquiries: Recent Attempts to Obtain New Credit

The lender must review the section of the borrower's credit report that indicates the presence of creditor inquiries to determine the number and recency of the inquiries.

Recent inquiries may indicate that the borrower has been actively seeking new credit accounts. The presence of a large number of unrelated inquiries represents higher credit risk (whether or not the borrower actually obtained credit as a result of the inquiry). The presence of many recent inquiries in combination with a significant number of recently opened accounts or delinquent accounts represents a high credit risk.

When the credit report indicates that recent inquiries took place, the lender must confirm that the borrower has not obtained any additional credit that is not reflected in the credit report or the mortgage application. If additional credit was obtained, a verification of that debt must be provided and the borrower must be qualified with the monthly payment.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-05, Credit Utilization (05/31/2016)

### B3-5.3-05, Credit Utilization (05/31/2016)

#### Introduction

This topic contains information on credit utilization.

#### Credit Utilization

When manually underwriting a loan, the lender must review the borrower's credit report to evaluate his or her use of revolving credit by comparing the current balance on each open account to the amount of credit that is available to determine whether the borrower has a pattern of using revolving accounts up to (or approaching) the credit limit. Patterns of revolving credit spending are credit risk indicative.

Credit histories that include revolving accounts with a low balances-to-limits ratio generally represent a lower credit risk, while those that include accounts with a high balances-to-limits ratio represent a higher credit risk.

A credit history that includes recently opened accounts that are at or near their limits may indicate that the borrower is overextended or overly reliant on the use of revolving credit—and, when this is combined with a delinquent payment history, it is generally an indication that the borrower has not managed his or her credit successfully.

**Note:** Lenders are not required to analyze trended credit data in the credit report. See B3-5.2-01, Requirements for Credit Reports (08/29/2017), for additional information.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2016-04	May 31, 2016

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-06, Authorized Users of Credit (10/30/2009)

### **B3-5.3-06, Authorized Users of Credit (10/30/2009)**

#### **Introduction**

This topic contains information on authorized users of credit

- Authorized Users of Credit
- Consideration of Authorized User Accounts

#### **Authorized Users of Credit**

When a credit account owner permits another person, typically a family member who is managing credit for the first time, to have access to and use an account, the user is referred to as an authorized user of the account. This practice is intended to assist related individuals in legitimately establishing a credit history and credit score based on the account and payment history of the account owner, even though the authorized user is not the account owner.

#### **Consideration of Authorized User Accounts**

For manually underwritten loans, credit report tradelines that list a borrower as an authorized user cannot be considered in the underwriting decision, except as outlined below.

An authorized user tradeline may be considered if:

- another borrower in the mortgage transaction is the owner of the tradeline; or
- the borrower can provide written documentation (e.g., canceled checks, payment receipts, etc.) that he or she has been the actual and sole payer of the monthly payment on the account for at least 12 months preceding the date of the application.

If written documentation of the borrower's monthly payments on the authorized user tradeline is provided, then the payment history — particularly any late payments that are indicated — must be considered in the credit analysis and the monthly payment obligation must be included in the debt-to-income ratio.

An authorized user tradeline must be considered if the owner of the tradeline is the borrower's spouse and the spouse is not a borrower in the mortgage transaction.

These requirements do not apply to loan casefiles underwritten through DU. For DU requirements, see B3-5.3-09, DU Credit Report Analysis (12/04/2019).

#### **Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement -2009-32	October 30, 2009
Announcement 08-01	January 31, 2008

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-07, Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (08/07/2019)

### **B3-5.3-07, Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (08/07/2019)**

#### **Introduction**

This topic contains information on the waiting periods for significant derogatory credit events, including:

- General Information
- Identification of Significant Derogatory Credit Events in the Credit Report
- Bankruptcy (Chapter 7 or Chapter 11)
- Bankruptcy (Chapter 13)
- Multiple Bankruptcy Filings
- Foreclosure
- Foreclosure and Bankruptcy on the Same Mortgage
- Deed-in-Lieu of Foreclosure, Preforeclosure Sale, and Charge-Off of a Mortgage Account
- Summary — All Waiting Period Requirements
- Requirements for Re-establishing Credit

#### **General Information**

The presence of significant derogatory credit events dramatically increases the likelihood of a future default and represents a significantly higher level of default risk. Examples of significant derogatory credit events include bankruptcies, foreclosures, deeds-in-lieu of foreclosure, preforeclosure sales, short sales, and charge-offs of mortgage accounts.

**Note:** The terms "preforeclosure sale" and "short sale" are used interchangeably in this Guide and have the same meaning (see Deed-in-Lieu of Foreclosure, Preforeclosure Sale, and Charge-Off of a Mortgage Account below).

The lender must determine the cause and significance of the derogatory information, verify that sufficient time has elapsed since the date of the last derogatory information, and confirm that the borrower has re-established an acceptable credit history. The lender must make the final decision about the acceptability of a borrower's credit history when significant derogatory credit information exists.

This topic describes the amount of time that must elapse (the "waiting period") after a significant derogatory credit event before the borrower is eligible for a new loan salable to Fannie Mae. The waiting period commences on the completion, discharge, or dismissal date (as applicable) of the derogatory credit event and ends on the disbursement date of the new loan for manually underwritten loans. See B3-5.3-09, DU Credit Report Analysis (12/04/2019), for additional information pertaining to DU loan casefiles, including how the waiting period is determined. Also see B3-5.3-08, Extenuating Circumstances for Derogatory Credit (12/16/2014), for additional information.

**Note:** The requirements pertaining to significant derogatory credit are not applicable to high LTV refinance loans. (See B5-7-02, High LTV Refinance Underwriting, Documentation, and Collateral Requirements for the New Loan (12/16/2020).)

## Identification of Significant Derogatory Credit Events in the Credit Report

Lenders must review the credit report and the Declarations in the loan application to identify instances of significant derogatory credit events. Lenders must review the public records section of the credit report and all tradelines, including mortgage accounts (first liens, second liens, home improvement loans, HELOCs, and manufactured home loans), to identify previous foreclosures, deeds-in-lieu, preforeclosure sales, charge-offs of mortgage accounts, and bankruptcies. Lenders must carefully review the current status of each tradeline, manner of payment codes, and remarks to identify these types of significant derogatory credit events. Remarks Codes are descriptive text or codes that appear on a tradeline, such as "Foreclosure," "Forfeit deed-in-lieu of foreclosure," and "Settled for less than full balance."

Significant derogatory credit events may not be accurately reported or consistently reported in the same manner by all creditors or credit reporting agencies. If not clearly identified in the credit report, the lender must obtain copies of appropriate documentation. The documentation must establish the completion date of a previous foreclosure, deed-in-lieu or preforeclosure sale, or date of the charge-off of a mortgage account; confirm the bankruptcy discharge or dismissal date; and identify debts that were not satisfied by the bankruptcy. Debts that were not satisfied by a bankruptcy must be paid off or have an acceptable, established repayment schedule.

**Note:** Timeshare accounts are considered installment loans and are not subject to the waiting periods described below.

### Bankruptcy (Chapter 7 or Chapter 11)

A four-year waiting period is required, measured from the discharge or dismissal date of the bankruptcy action.

#### Exceptions for Extenuating Circumstances

A two-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the discharge or dismissal date of the bankruptcy action.

### Bankruptcy (Chapter 13)

A distinction is made between Chapter 13 bankruptcies that were discharged and those that were dismissed. The waiting period required for Chapter 13 bankruptcy actions is measured as follows:

- two years from the discharge date, or
- four years from the dismissal date.

The shorter waiting period based on the discharge date recognizes that borrowers have already met a portion of the waiting period within the time needed for the successful completion of a Chapter 13 plan and subsequent discharge. A borrower who was unable to complete the Chapter 13 plan and received a dismissal will be held to a four-year waiting period.

#### Exceptions for Extenuating Circumstances

A two-year waiting period is permitted after a Chapter 13 dismissal, if extenuating circumstances can be documented. There are no exceptions permitted to the two-year waiting period after a Chapter 13 discharge.

### Multiple Bankruptcy Filings

For a borrower with more than one bankruptcy filing within the past seven years, a five-year waiting period is required, measured from the most recent dismissal or discharge date.

**Note:** The presence of multiple bankruptcies in the borrower's credit history is evidence of significant derogatory credit and increases the likelihood of future default. Two or more borrowers with individual bankruptcies are not cumulative, and do not constitute multiple bankruptcies. For example, if the borrower has one bankruptcy and the co-borrower has one bankruptcy this is not considered a multiple bankruptcy.

#### Exceptions for Extenuating Circumstances

A three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the most recent bankruptcy discharge or dismissal date. The most recent bankruptcy filing must have been the result of extenuating circumstances.

### Foreclosure

A seven-year waiting period is required, and is measured from the completion date of the foreclosure action as reported on the credit report or other foreclosure documents provided by the borrower.

#### Exceptions for Extenuating Circumstances

A three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the completion date of the foreclosure action. Additional requirements apply between three and seven years, which include:

- Maximum LTV, CLTV, or HCLTV ratios of the lesser of 90% or the maximum LTV, CLTV, or HCLTV ratios for the transaction per the *Eligibility Matrix*.
- The purchase of a principal residence is permitted.
- Limited cash-out refinances are permitted for all occupancy types pursuant to the eligibility requirements in effect at that time.

**Note:** The purchase of second homes or investment properties and cash-out refinances (any occupancy type) are not permitted until a seven-year waiting period has elapsed.

## Foreclosure and Bankruptcy on the Same Mortgage

If a mortgage debt was discharged through a bankruptcy, the bankruptcy waiting periods may be applied if the lender obtains the appropriate documentation to verify that the mortgage obligation was discharged in the bankruptcy. Otherwise, the greater of the applicable bankruptcy or foreclosure waiting periods must be applied.

## Deed-in-Lieu of Foreclosure, Preforeclosure Sale, and Charge-Off of a Mortgage Account

These transaction types are completed as alternatives to foreclosure.

- A deed-in-lieu of foreclosure is a transaction in which the deed to the real property is transferred back to the servicer. These are typically identified on the credit report through Remarks Codes such as "Forfeit deed-in-lieu of foreclosure."
- A preforeclosure sale or short sale is the sale of a property in lieu of a foreclosure resulting in a payoff of less than the total amount owed, which was pre-approved by the servicer. These are typically identified on the credit report through Remarks Codes such as "Settled for less than full balance."
- A charge-off of a mortgage account occurs when a creditor has determined that there is little (or no) likelihood that the mortgage debt will be collected. A charge-off is typically reported after an account reaches a certain delinquency status, and is identified on the credit report with a manner of payment (MOP) code of "9."

A four-year waiting period is required from the completion date of the deed-in-lieu of foreclosure, preforeclosure sale, or charge-off as reported on the credit report or other documents provided by the borrower.

### Exceptions for Extenuating Circumstances

A two-year waiting period is permitted if extenuating circumstances can be documented.

**Note:** Deeds-in-lieu and preforeclosure sales may not be accurately or consistently reported in the same manner by all creditors or credit reporting agencies. See Identification of Significant Derogatory Credit Events in the Credit Report above for additional information.

## Summary – All Waiting Period Requirements

The following table summarizes the waiting period requirements for all significant derogatory credit events.

Derogatory Event	Waiting Period Requirements	Waiting Period with Extenuating Circumstances
Bankruptcy — Chapter 7 or 11	4 years	2 years
Bankruptcy — Chapter 13	<ul style="list-style-type: none"> <li>• 2 years from discharge date</li> <li>• 4 years from dismissal date</li> </ul>	<ul style="list-style-type: none"> <li>• 2 years from discharge date</li> <li>• 2 years from dismissal date</li> </ul>
Multiple Bankruptcy Filings	5 years if more than one filing within the past 7 years	3 years from the most recent discharge or dismissal date
Foreclosure <sup>1</sup>	7 years	3 years Additional requirements after 3 years up to 7 years: <ul style="list-style-type: none"> <li>• 90% maximum LTV ratios<sup>2</sup></li> <li>• Purchase, principal residence</li> <li>• Limited cash-out refinance, all occupancy types</li> </ul>
Deed-in-Lieu of Foreclosure, Preforeclosure Sale, or Charge-Off of Mortgage Account	4 years	2 years

<sup>1</sup> When both a bankruptcy and foreclosure are disclosed on the loan application, or when both appear on the credit report, the lender may apply the bankruptcy waiting period if the lender obtains the appropriate documentation to verify that the mortgage loan in question was discharged in the bankruptcy. Otherwise, the greater of the applicable bankruptcy or foreclosure waiting period must be applied.

<sup>2</sup> References to LTV ratios include LTV, CLTV, and HCLTV ratios. The maximum LTV ratios permitted are the lesser of the LTV ratios in this table or the maximum LTV ratios for the transaction per the *Eligibility Matrix*.

## Requirements for Re-establishing Credit

After a bankruptcy, foreclosure, deed-in-lieu of foreclosure, preforeclosure sale, or charge-off of a mortgage account, the borrower's credit will be considered re-established if all of the following are met:

- The waiting period and the related additional requirements are met.
- The loan receives a recommendation from DU that is acceptable for delivery to Fannie Mae or, if manually underwritten, meets the minimum credit score requirements based on the parameters of the loan and the established eligibility requirements.
- The borrower has traditional credit as outlined in Section B3-5.3, Traditional Credit History. Nontraditional credit or "thin files" are not acceptable.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2017-06	July 25, 2017

Announcement SEL-2014-10	July 29, 2014
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2011-12	November 15, 2011
Announcement SEL-2011-04	May 24, 2011
Announcement SEL-2010-09	June 30, 2010
Announcement SEL-2010-08	June 23, 2010
Announcement SEL-2010-06	April 30, 2010
Announcement SEL-2010-05	April 14, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-08, Extenuating Circumstances for Derogatory Credit (12/16/2014)

### **B3-5.3-08, Extenuating Circumstances for Derogatory Credit (12/16/2014)**

#### **Introduction**

This topic provides information on extenuating circumstances for derogatory credit information.

#### **Extenuating Circumstances**

Extenuating circumstances are nonrecurring events that are beyond the borrower's control that result in a sudden, significant, and prolonged reduction in income or a catastrophic increase in financial obligations.

If a borrower claims that derogatory information is the result of extenuating circumstances, the lender must substantiate the borrower's claim. Examples of documentation that can be used to support extenuating circumstances include

- documents that confirm the event
  - such as a copy of a divorce decree, medical reports or bills, notice of job layoff, job severance papers, etc.; and
- documents that illustrate factors that contributed to the borrower's inability to resolve the problems that resulted from the event
  - such as a copy of insurance papers or claim settlements, property listing agreements, lease agreements, tax returns (covering the periods prior to, during, and after a loss of employment), etc.

The lender must obtain a written explanation from the borrower explaining the relevance of the documentation. The written explanation must support the claims of extenuating circumstances, confirm the nature of the event that led to the bankruptcy or foreclosure-related action, and illustrate that the borrower had no reasonable options other than to default on his or her financial obligations. The written explanation may be in the form of a letter from the borrower, an email from the borrower, or some other form of written documentation provided by the borrower.

#### **Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

<b>Announcements</b>	<b>Issue Dates</b>
Announcement SEL-2014-16	December 16, 2014

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.3, Traditional Credit History > B3-5.3-09, DU Credit Report Analysis (12/04/2019)

### **B3-5.3-09, DU Credit Report Analysis (12/04/2019)**

#### **Introduction**

This topic describes how DU analyzes credit report data and requirements lenders must follow in response to the credit-related Findings messages. This topic includes:

- Inquiries
- Trended Credit Data
- Omitted Accounts
- Authorized User Tradelines
- Disputed Credit Report Tradelines
- DU Debt Comparison
- Contradictory, Derogatory, or Erroneous Information
- Duplicate Public Records
- Judgments and Liens
- Mortgage Delinquencies
- Past-Due, Collection, and Charge-Off of Non-Mortgage Accounts
- Prior Bankruptcy, Foreclosure, Deed-in-Lieu of Foreclosure, Preforeclosure Sales, and Charge-Off of Mortgage Accounts
- Bankruptcy
- Foreclosure
- Deed-in-Lieu of Foreclosure

- Preforeclosure Sales or Short Sales
- Charge-Off of Mortgage Accounts

## Inquiries

The lender should examine inquiries to determine whether they represent potential sources of undisclosed credit. If new debt was obtained, the lender may need to correct the loan application and resubmit it.

## Trended Credit Data

Lenders are not required to analyze trended credit data in the credit report. For more information, see B3-2-03, Risk Factors Evaluated by DU (12/16/2020).

## Omitted Accounts

Supporting documentation is required when a credit report liability with a balance greater than zero is omitted from the loan application.

## Authorized User Tradelines

DU takes credit report tradelines designated as authorized user tradelines into consideration as part of the DU credit risk assessment. However the lender must review credit report tradelines in which the applicant has been designated as an authorized user in order to ensure the tradelines are an accurate reflection of the borrower's credit history. If the lender believes the authorized user tradelines are not an accurate reflection of the borrower's credit history, the lender should evaluate the borrower's credit history without the benefit of these tradelines and use prudent underwriting judgment when making its final underwriting decision. In order to assist the lender in its review of authorized user tradelines, DU issues a message providing the name of the creditor and account number for each authorized user tradeline identified.

When ensuring tradelines are an accurate reflection of the borrower's credit history, as a general guide, if the borrower has several authorized user accounts but only has a few accounts of his/her own, the lender should establish:

- the relationship of the borrower to the owner of the account,
- if the borrower uses the account, and
- if the borrower makes the payments on the account.

If the authorized user tradeline belongs to another borrower on the mortgage loan, no additional investigation is needed. On the other hand, if the borrower has several tradelines in good standing and only a minor number of authorized user accounts, the lender could make the determination that:

- the authorized user accounts had minimal, if any, impact on the borrower's overall credit profile; and
- the information reported on the credit report is an accurate reflection of the borrower's credit history.

The lender is not required to review an authorized user tradelines that belongs to the borrower's spouse when the spouse is not on the mortgage transaction.

For manual underwriting consideration of authorized users of credit, see B3-5.3-06, Authorized Users of Credit (10/30/2009).

## Disputed Credit Report Tradelines

When the credit report contains tradelines disputed by the borrower, DU will first assess the risk of the loan casefile using all tradelines, including those disputed. If DU issues an Approve recommendation using the disputed tradelines, no further documentation or action is necessary. DU will issue a message specific to this scenario.

If DU does not issue an Approve recommendation when including the disputed tradelines, DU will re-assess the risk without using the disputed tradelines. If DU is then able to issue an Approve recommendation, the lender must investigate the tradelines to determine whether the borrower is responsible for the accounts or if the account information is accurate or complete.

- If the borrower is not responsible for the disputed accounts, the lender must obtain supporting documentation and may deliver the loan as a DU loan. No further action is necessary regarding the disputed tradelines.
- If the borrower is responsible for the disputed account, the lender must investigate the information, including determining the aspect of the tradeline that is being disputed. If the borrower is able to provide documentation to disprove any adverse information (such as canceled checks), the lender may deliver the loan as a DU loan.
- If the borrower is responsible for the disputed account and the account and tradeline information is accurate and complete, the loan is not eligible for delivery as a DU loan. The lender may manually underwrite the loan if the transaction is eligible for manual underwriting.

The monthly payments for the disputed tradelines must be included in the debt-to-income ratio if the accounts belong to the borrower.

**Note:** Tradelines reported as medical debt are not shown in the disputed tradeline message. Therefore, lenders are not required to investigate disputed medical tradelines.

## Examples

The following scenarios are examples of when a loan receiving an Approve/Eligible recommendation with the disputed tradeline(s) excluded from DU's risk assessment would be eligible for delivery as a DU loan:

- A borrower's account was referred for collection by the creditor. Subsequently, the borrower paid off the account, but the pay-off was not reported on the tradeline. The borrower requested that a dispute be placed on the tradeline. The tradeline information was accurate, but because it did not reflect that the borrower paid off the account, it may be considered incomplete. The borrower must provide documentation that the account was paid in full.
- A borrower and his son have the same name (Sr. and Jr.). The borrower's credit report contains a tradeline that actually belongs to the son. The tradeline is reported as disputed. The borrower can provide confirmation that he is not obligated on the account.
- The servicer of a disputed loan indicates a late payment in January of the previous year. The borrower can provide documentation (such as canceled checks or bank statements) that indicate that the payment was made on time.

The following scenario is an example of when a loan receiving an Approve/Eligible recommendation with the disputed tradeline(s) excluded from DU's risk assessment would not be eligible for delivery as a DU loan:

- The credit report indicates a disputed tradeline on the borrower's mortgage being refinanced. The tradeline indicates a 60-day late payment in January of the previous year. The borrower cannot provide any documentation to support that the payment was made on time.

## DU Debt Comparison

DU compares the balances and payments of the debts on the credit report with the debts on the loan application. If material differences are found, the lender must confirm that all debts from the credit report are included on the loan application and provide documentation to support the use of payments and balances lower than those on the credit report. If the debt affects the debt-to-income ratio by more than the allowable tolerances, the lender must add the debt to the loan application and resubmit the loan. Otherwise, the lender is expected to provide documentation that supports the omission from the loan application. See B3-6-02, Debt-to-Income Ratios (02/05/2020), and B3-2-10, Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report (12/04/2019), for additional information.)

## Contradictory, Derogatory, or Erroneous Information

Lenders are obligated to take action when contradictory, derogatory, or erroneous information would justify additional investigation or would provide grounds for a decision that is different from the recommendation DU delivers. For example, if the credit report reflects a previous foreclosure but the information was not accurately mapped to DU, the lender must consider this when making its final underwriting decision.

## Duplicate Public Records

Items that typically appear in the Public Records section of the credit report (judgments, bankruptcies, foreclosures, and tax liens) are often duplicated because the credit agencies may not attempt to merge items of this severe nature. As a result, these items may also appear in more than one verification message in the Underwriting Findings report. If it is clear from the credit report data that the items are duplicates (identical account numbers, date filed, and dollar amounts), the lender can disregard the duplicates and document the item once. However, if it is unclear from the credit report whether any of the items are duplicated, the lender should treat each item individually and obtain the required documentation for each item, as indicated in the verification messages.

## Judgments and Liens

Open judgments and all outstanding liens that are in the Public Records section of the credit report will be identified in the Underwriting Findings report, and must be paid off at or prior to closing. Documentation of the satisfaction of these liabilities, along with verification of funds sufficient to satisfy these obligations, must also be maintained in the permanent loan file.

## Mortgage Delinquencies

DU applies the following guidelines to the processing of loans with mortgage delinquencies:

- If any borrower's credit report contains a mortgage tradeline that is 60 or more days past due when the account was last reported by the creditor and the account was reported within the 12 months prior to the credit report date, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- If there is a mortgage that is disclosed on the loan application but not reported on the credit report, or the mortgage is on the credit report with an outstanding balance but the payment history has not been reported in the last six months, DU will issue a message requiring the lender to confirm that the account is not two or more payments past due as of the date of the application and that it has not been past due by two or more payments in the last 12 months. If the lender determines that the borrower does have a mortgage that is past due by two or more payments or has been past due by two or more payments in the last 12 months, then the loan casefile is not eligible for delivery to Fannie Mae.
- Borrowers may not bring past-due mortgage accounts current prior to closing in order to circumvent Fannie Mae's policy regarding past-due mortgages. However, the lender may apply some discretion with regard to the application of this policy if it determines and documents that the past-due account status was not the fault of the borrower—for example, if the servicer misapplied or lost the borrower's payment.
- Loan casefiles will receive an Ineligible recommendation due to excessive prior mortgage delinquency if the borrower has a mortgage tradeline on his or her credit report that has one or more 60-, 90-, 120-, or 150-day delinquency reported within the 12 months prior to the credit report date.

The above policies will apply to all mortgage tradelines, including first liens, second liens, home improvement loans, HELOCs, and manufactured home loans.

## Underwriting when the Credit Report Contains Inaccurate Mortgage Delinquency Information

- When DU identifies a mortgage delinquency on the credit report and the information is inaccurate, the lender may instruct DU to disregard the mortgage delinquency information on the credit report. This is done by entering "Confirmed Mtg Del Incorrect" in the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the mortgage delinquency information on the credit report will not be used.
- If the lender enters "Confirmed Mtg Del Incorrect", the lender must document that the mortgage is not currently 60 days or more past due, and has not been 60 days or more past due in the last 12 months.

## Past-Due, Collection, and Charge-Off of Non-Mortgage Accounts

Accounts that are reported as past due (not reported as collection accounts) must be brought current.

- For one-unit, principal residence properties, borrowers are not required to pay off outstanding collections or non-mortgage charge-offs—regardless of the amount.

**Note:** If the lender marks the collection account Paid By Close in the online loan application, DU will issue a message in the DU Underwriting Findings report stating that the collection must be paid.

- For two- to four-unit owner-occupied and second home properties, collections and non-mortgage charge-offs totaling more than \$5,000 must be paid in full prior to or at closing.
- For investment properties, individual collection and non-mortgage charge-off accounts equal to or greater than \$250 and accounts that total more than \$1,000 must be paid in full prior to or at closing.

## Prior Bankruptcy, Foreclosure, Deed-in-Lieu of Foreclosure, Preforeclosure Sales, and Charge-Off of Mortgage Accounts

Per the requirements of B3-5.3-07, Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (08/07/2019), an amount of time must elapse (the "waiting period") after a significant derogatory credit event before the borrower is eligible for a new loan salable to Fannie Mae. The waiting period commences on the completion, discharge, or dismissal date (as applicable) of the derogatory credit event and ends on the disbursement date of the new loan. Because DU does not have the disbursement date of the subject loan, DU uses the date of the credit report to measure whether or not the applicable waiting period has been met. However, because the credit report date

may not result in an accurate calculation of the waiting period (it is earlier than the disbursement date), the lender may use the disbursement date to confirm that the waiting period has been met. See the table below for additional information.

Event	Measurement of Waiting Period
Bankruptcy Foreclosure	<ul style="list-style-type: none"> <li>If the completion, discharge, or dismissal dates (as applicable) reflected in the credit report are complete and appear to comply with the applicable waiting period requirements, DU will issue a recommendation, but the lender must still confirm that the waiting period has been met and may base its determination on the disbursement date of the new loan.</li> <li>If the completion, discharge, or dismissal dates (as applicable) reflected in the credit report are complete, but do not appear to comply with the applicable waiting period requirements, a Refer with Caution recommendation will be issued. DU uses the date of the credit report to determine whether or not the applicable waiting period has been met. The lender may obtain an updated credit report and resubmit the loan casefile to DU after the required time has elapsed or manually underwrite the loan using the disbursement date to confirm that the waiting period has been met.</li> <li>If the completion, discharge, or dismissal dates (as applicable) reflected in the credit report are incomplete, the lender must confirm that the waiting period has been met and may base its determination on the disbursement date of the new loan.</li> </ul>
Deed-in-Lieu of Foreclosure Preforeclosure Sale Mortgage Charge-Off	<ul style="list-style-type: none"> <li>DU will determine if the date of the event was within the applicable waiting period. However, the recommendation will not be changed and the lender must confirm the waiting period requirement has been met, and may base its determination on the disbursement date of the new loan.</li> </ul>

**Note:** See B3-5.3-07, Significant Derogatory Credit Events — Waiting Periods and Re-establishing Credit (08/07/2019), for additional information regarding significant derogatory events. DU is not able to identify whether the borrower's derogatory credit event(s) was the result of extenuating circumstances. See below for information on how to treat extenuating circumstances and B3-5.3-08, Extenuating Circumstances for Derogatory Credit (12/16/2014), for additional information.

## Bankruptcy

DU applies the following guidelines to prior bankruptcies:

- If a Chapter 13 bankruptcy was discharged within the last two years, dismissed within the last four years, or filed but neither discharged nor dismissed within the last four years, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- If a non-Chapter 13 bankruptcy was filed, discharged, or dismissed within the last four years, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- DU will not take bankruptcy information in the public record section of the credit report into account if the bankruptcy is dated more than seven years prior to the credit report date.
- DU will not take tradeline accounts that are reported with a bankruptcy status code or manner of payment (MOP) code of "7" into account if there is at least one bankruptcy reported in a public record within seven years of the credit report date. In this scenario, DU assumes the date filed and the date discharged in the public record are more accurate than the dates in the tradeline; i.e., specific filed and discharged dates do not exist in the tradeline.
- DU will use tradeline accounts that are reported with a bankruptcy status code or MOP code of "7" if there is not a bankruptcy reported in a public record within seven years of the credit report date. In this scenario, the lender will need to verify the actual filed and discharged dates to determine that the bankruptcy meets the DU bankruptcy policy.
- DU is not able to determine if multiple filings have occurred due to the manner in which bankruptcies are reported to the credit report. DU will issue a message when it appears that there may have been multiple bankruptcy filings. This message will list each of the bankruptcies seen on the credit report, and will instruct lenders to ensure the loan casefile meets the criteria for underwriting loan casefiles with multiple bankruptcies.

### Underwriting when the Credit Report Contains Inaccurate Bankruptcy Information

- When DU identifies a bankruptcy on the credit report and the information is inaccurate, the lender may instruct DU to disregard the bankruptcy information on the credit report in the eligibility assessment. This is done by entering "Confirmed CR BK Incorrect" in the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the bankruptcy information on the credit report will not be used.
- If the lender enters "Confirmed CR BK Incorrect", the lender must document that the Chapter 13 bankruptcy was discharged two or more years or dismissed four or more years from the disbursement date of the new loan, or that the non-Chapter 13 bankruptcy was discharged or dismissed four years or more years from the disbursement date of the new loan.

### Underwriting when a Bankruptcy Was Due to Extenuating Circumstances

- When DU identifies a bankruptcy on the credit report and that bankruptcy was due to extenuating circumstances, the lender may instruct DU to disregard the bankruptcy information on the credit report in the eligibility assessment. This is done by entering "Confirmed CR BK EC" in the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the bankruptcy information on the credit report will not be used.
- If the lender enters "Confirmed CR BK EC", the lender must document that the bankruptcy was due to extenuating circumstances, and that the Chapter 13 bankruptcy was dismissed two or more years from the disbursement date of the new loan, or that the non-Chapter 13 bankruptcy was discharged or dismissed two or more years from the disbursement date of the new loan.

## Foreclosure

DU applies the following guidelines to prior foreclosures:

- Mortgage accounts, including first liens, second liens, home improvement loans, HELOCs, and manufactured home loans, will be identified as a foreclosure if there is an MOP code of "8," or a Remarks Code that indicates a foreclosure is present in the credit report data and associated to the tradeline.
- If a foreclosure was reported within the seven-year period prior to the credit report date, the loan casefile will receive a Refer with Caution recommendation and will be ineligible for delivery to Fannie Mae.
- If the filed date and the satisfied date of the foreclosure are both unknown, but it appears that the foreclosure occurred within the seven-year period prior to the credit report date, the lender must confirm that the foreclosure did not occur within the most recent seven-year period.
- Foreclosure laws vary by state and the time it takes to complete the process may vary by state. DU assumes that the date the foreclosure was reported in the tradeline is the date of the foreclosure sale or liquidation. The lender must confirm that all foreclosures are satisfied.
- Mortgage accounts that are identified as a deed-in-lieu of foreclosure or preforeclosure sale will not be identified as a foreclosure.

### Underwriting when Inaccurate Foreclosure Information Exists

- When DU identifies a foreclosure on a credit report tradeline and the foreclosure information on that tradeline is inaccurate, the lender may instruct DU to disregard the foreclosure information on the credit report in the eligibility assessment. This is done by entering "Confirmed CR FC Incorrect" in the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the foreclosure information on the credit report tradeline will not be used in the eligibility assessment.
- If the lender enters "Confirmed CR FC Incorrect," the lender must then document the foreclosure was completed seven or more years from the disbursement date of the new loan, or that the account was not subject to foreclosure and the loan complies with all other applicable requirements.

### Underwriting when Extenuating Circumstances Exist

- When DU identifies a foreclosure on a credit report tradeline and that foreclosure was due to extenuating circumstances, the lender may instruct DU to disregard the foreclosure information on the credit report in the eligibility assessment. This is done by entering "Confirmed CR FC EC" in the online loan application and resubmitting the loan casefile to DU. When the loan casefile is resubmitted to DU, the foreclosure information on the credit report tradeline will not be used in the eligibility assessment.
- If the lender enters "Confirmed CR FC EC," the lender must then document that the foreclosure was due to extenuating circumstances, the foreclosure was completed three or more years from the disbursement date of the new loan, and the loan complies with all other requirements specific to a foreclosure due to extenuating circumstances.

## Deed-in-Lieu of Foreclosure

DU applies the following guidelines to prior DILs:

- DU will determine if a mortgage tradeline is a DIL by using specific Remarks Codes that are present in the credit report data and associated to the tradeline.
- When DU identifies a DIL, the lender must document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when the lender confirms that the mortgage loan meets the applicable time frames and eligibility requirements for a deed-in-lieu of foreclosure due to extenuating circumstances.

## Preforeclosure Sales or Short Sales

- DU will determine if a mortgage tradeline is a PFS by using specific Remarks Codes that are present in the credit report data and associated to the tradeline.
- When DU identifies a PFS, the lender must document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when the lender confirms that the mortgage loan meets the applicable time frames and eligibility requirements for a preforeclosure sale due to extenuating circumstances.

## Charge-Off of Mortgage Accounts

- Mortgage accounts, including first liens, second liens, home improvements loans, HELOCs, and manufactured home loans, will be identified as a charge-off if there is an MOP code of "9" (collection or charge-off) and there is no information indicating the account may also be subject to a foreclosure (MOP code "8" or foreclosure Remarks Code), a deed-in-lieu of foreclosure (DIL Remarks Code), or a preforeclosure sale (PFS Remarks Code).
- When DU identifies a charge-off on a mortgage tradeline, the lender must document that the event was completed four or more years from the disbursement date of the new loan, or two or more years from the disbursement date of the new loan when the lender confirms that the mortgage loan meets the applicable time frames and eligibility requirements for a charge-off due to extenuating circumstances.

## Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2018-05	June 05, 2018
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-04	May 31, 2016
Announcement SEL-2015-12	November 3, 2015
Announcement SEL-2015-03	March 31, 2015
Announcement SEL-2015-01	January 27, 2015

Announcement SEL-2014-10	July 29, 2014
DU Version 9.1	June 17, 2014
Announcement SEL-2014-03	April 15, 2014
Announcement SEL-2013-07	September 24, 2013
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
DU Version 9.0	July 24, 2012
Announcement SEL-2012-04	May 15, 2012
Announcement SEL-2011-11	October 25, 2011
Announcement SEL-2011-04	May 24, 2011
Announcement SEL-2011-01	January 27, 2011
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
Announcement SEL-2010-11	August 13, 2010
Announcement SEL-2010-08	June 23, 2010
Announcement SEL-2010-06	April 30, 2010
Announcement SEL-2010-05	April 14, 2010
Announcement SEL-2010-02	March 2, 2010
Announcement -2009-32	October 30, 2009
DU Version 8.0	September 22, 2009
DU Version 7.1	October 31, 2008

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.4, Nontraditional Credit History > B3-5.4-01, Eligibility Requirements for Loans with Nontraditional Credit (12/19/2017)

### **B3-5.4-01, Eligibility Requirements for Loans with Nontraditional Credit (12/19/2017)**

#### **Introduction**

This topic contains information on nontraditional credit eligibility requirements, including:

- Overview
- Unacceptable Uses
- Manual Underwriting: At Least One Borrower Has No Credit Score
- DU Loan Casefiles: No Borrower Has a Credit Score
- DU Loan Casefiles: At Least One Borrower Has No Credit Score and Another Borrower Has a Credit Score
- Homeownership Education

#### **Overview**

If one or more borrowers do not have a credit score due to insufficient credit, the lender must establish an acceptable nontraditional credit profile. The lender must first check all three major credit repositories to verify the borrower's credit history and confirm that the borrower does not have a credit score.

If the borrower's credit information is frozen at one of the credit repositories, and no credit score is available from any other repository, the lender may underwrite the borrower following the requirements for nontraditional credit. If the borrower's credit information is frozen at two or more of the credit repositories, the loan is not eligible as nontraditional credit even though no credit score is available.

The credit report will indicate if a credit score could not be produced due to insufficient credit. Lenders must ensure that the credit report accurately reflects the borrower's information, such as the name, Social Security number, and current residence of the borrower to confirm that the lack of traditional credit was not erroneously reported because incorrect information was used to order the credit report.

**Note:** For certain loan transactions, one or more borrower(s) are required to have traditional credit as evidenced by a credit score. See below for additional information.

#### **Unacceptable Uses**

The establishment of a nontraditional credit history is not acceptable for the following scenarios:

- The lender is able to obtain a credit score for the borrower despite the borrower's limited use of credit.
- The borrower has a sufficient amount of credit to obtain a credit score and the representative credit score is less than the minimum required.

**Note:** An exception is permitted for certain HomeReady loans for borrowers with low credit scores. See B5-6-02, HomeReady Mortgage Underwriting Methods and Requirements (07/03/2019), for additional information.

- The borrower's traditional credit history indicates significant derogatory references, such as a prior bankruptcy or foreclosure. In these cases, the borrower must have re-established credit in accordance with B3-5.3-07, Significant Derogatory Credit Events — Waiting

Periods and Re-establishing Credit (08/07/2019), including the establishment of traditional credit and a credit score.

### Manual Underwriting: At Least One Borrower Has No Credit Score

If one or more borrowers on the loan does not have a credit score and is relying on nontraditional credit to qualify, the following requirements apply:

- The property must be a one-unit, principal residence.
- The transaction must be a purchase or limited cash-out refinance.
- The loan amount must meet the general loan limits—high-balance mortgage loans are not eligible.
- The maximum debt-to-income ratio is 36%.
- There is no minimum reserve requirement if at least one borrower can document a rental payment history as one source of nontraditional credit. Otherwise, a minimum of 12 months reserves is required. See B3-5.4-02, Number and Types of Nontraditional Credit Sources (08/30/2016), for additional information.
- Non-occupant co-borrowers are permitted, provided the requirements described in B2-2-04, Guarantors, Co-Signers, or Non-Occupant Borrowers on the Subject Transaction (09/02/2020), are met in addition to the eligibility requirements described above.
- A nontraditional credit history must be documented for each borrower without a credit score. See B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016), for additional information.

### DU Loan Casefiles: No Borrower Has a Credit Score

Lenders may submit loan casefiles to DU when no borrower has a credit score. DU will apply the following requirements:

- The property must be a one-unit, principal residence, and all borrowers must occupy the property.
- All property types are permitted, with the exception of manufactured housing.
- The transaction must be a purchase or limited cash-out refinance.
- The loan amount must meet the general loan limits—high-balance mortgage loans are not eligible.
- The loan must be a fixed-rate mortgage.
- The maximum LTV, CLTV, and HCLTV ratios are 90%.
- The debt-to-income ratio must be less than 40%.
- Reserves may be required as determined by DU.
- A nontraditional credit history must be documented for each borrower without a credit score. See B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016), for additional information.

If a loan casefile does not receive an Approve/Eligible recommendation, the loan may still be eligible for manual underwriting. The lender must determine whether the loan meets the requirements for a manually underwritten loan that includes a borrower without a credit score.

### DU Loan Casefiles: At Least One Borrower Has No Credit Score and Another Borrower Has a Credit Score

If one (or more) borrower(s) has a credit score and at least one borrower does not have a credit score, then DU will apply the following requirements:

- The property must be a one-unit, principal residence, and all borrowers must occupy the property.
- The transaction must be a purchase or limited cash-out refinance.
- The loan amount must meet the general loan limits—high-balance mortgage loans are not eligible.
- Reserves may be required as determined by DU.
- If the borrower(s) with a credit score is contributing more than 50% of the qualifying income, the lender is not required to document a nontraditional credit history for the borrower(s) without a credit score.
- If the borrower(s) with a credit score is contributing 50% or less of the qualifying income, the lender must document a nontraditional credit history for each borrower without a credit score. See B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016), for additional information.

### Homeownership Education

If all borrowers on the loan are relying solely on nontraditional credit to qualify, at least one borrower must complete homeownership education prior to loan closing. See B2-2-06, Homeownership Education and Housing Counseling (10/02/2019), for the requirements.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2017-10	December 19, 2017
Announcement SEL-2017-02	February 28, 2017
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2012-07	August 21, 2012
Announcement -2009-12	May 4, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.4, Nontraditional Credit History > B3-5.4-02, Number and Types of Nontraditional Credit Sources (08/30/2016)

### B3-5.4-02, Number and Types of Nontraditional Credit Sources (08/30/2016)

#### Introduction

This topic contains information on nontraditional credit sources, including

- Number of Nontraditional Credit Sources Required
- Eligible Types of Nontraditional Credit

### Number of Nontraditional Credit Sources Required

The number of nontraditional credit sources that must be documented for a borrower without a credit score differs depending on the underwriting method and loan product, as described in the table below:

Underwriting Method	Number of Nontraditional Credit Sources Required	
	Loans other than HomeReady Loans	HomeReady Loans
Manually underwritten loans	<ul style="list-style-type: none"> <li>• Four sources for each borrower without a credit score</li> </ul>	<ul style="list-style-type: none"> <li>• Three sources for each borrower without a credit score</li> <li>• If there is a borrower on the loan without a credit score who cannot document a nontraditional credit profile (because the borrower has no nontraditional credit sources), the transaction is still eligible, provided no more than 30% of the qualifying income for the mortgage loan comes from that borrower.</li> </ul>
Loans underwritten through DU	<ul style="list-style-type: none"> <li>• If no borrower has a credit score               <ul style="list-style-type: none"> <li>- at least two sources for each borrower</li> </ul> </li> </ul>	
	<ul style="list-style-type: none"> <li>• If the borrower(s) with a credit score contributes               <ul style="list-style-type: none"> <li>- 50% or less of qualifying income, at least two sources for each borrower without a credit score.</li> <li>- more than 50% of qualifying income, then no nontraditional credit history is required for the borrower(s) without a credit score.</li> </ul> </li> </ul>	

### Eligible Types of Nontraditional Credit

The types of credit that can be used to develop a nontraditional credit history are those that require the borrower to make periodic payments on a regular basis with intervals that are no longer than every three months.

The lender must conduct an informational interview with the borrower to identify all of the sources from which the borrower obtained credit over the most recent consecutive 12 months. If the lender is requesting a nontraditional mortgage credit report from a consumer reporting agency, the agency will conduct the borrower interview and obtain the list of available nontraditional credit sources.

In all cases, the payment history for each credit reference must be documented for the most recent consecutive 12-month period. All credit sources must be included, not just those that reflect acceptable performance.

The following nontraditional credit sources may be used to develop a nontraditional credit history for the borrower:

- Rental housing payments. This includes payments made to a landlord or management company. Also included are payments made on a privately-held mortgage loan that is not reported to the credit bureaus, contract for deed payments and other similar arrangements, provided the payments are related to the borrower's housing.
  - Loans underwritten through DU where a nontraditional credit history is required must include rental housing payments as one source of nontraditional credit.
  - Manually underwritten loans do not require that one source of nontraditional credit be rental housing payments. However, if no borrower on the loan is able to document a rental payment history, a minimum of 12 months' reserves must be documented.
- Utilities, such as electricity, gas, water, telephone service, television, and internet service providers. If utilities are included in the rental housing payment, they cannot be considered a separate source of nontraditional credit. Utilities can be considered a source of nontraditional credit only if the payment history can be separately documented.
- Medical insurance coverage (excluding payroll deductions)
- Automobile insurance payments
- Cell phone payments
- Life insurance policies (excluding payroll deductions)
- Payments for household or renter's insurance
- Payments to local stores, such as department stores, furniture stores, appliance stores
- Rental payments for durable goods, such as automobiles
- Payment of medical bills
- Payment of school tuition
- Payments for child care
- A loan obtained from an individual, provided the repayment terms can be documented in a written agreement
- Checking account, savings account, voluntary payments made to a payroll savings plan or contributions to a stock purchase plan, provided the records reflect an increasing balance as a result of periodic deposits over at least the most recent 12 months. Contributions must have been made no less than quarterly.
- Wire remittance statements demonstrating a consistent amount of funds remitted over the most recent 12-month period.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2016-07	August 30, 2016
Announcement -2009-12	May 4, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-5, Credit Assessment > Section B3-5.4, Nontraditional Credit History > B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016)

### **B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016)**

#### **Introduction**

This topic contains information on the documentation and assessment of a nontraditional credit history, including:

- General Documentation Requirements
- Rental Payment History
- Standards for Individual Credit References Obtained Directly from a Creditor
- Standards for Documenting Payment History Obtained From the Borrower
- Verification of Bank Accounts and Wire Remittance Statements
- Borrowers with Disabilities
- Non-U.S. Citizen and Foreign Borrowers
- Assessment of the Payment History for Nontraditional Credit Sources

#### **General Documentation Requirements**

The lender can document the borrower's nontraditional credit history directly from the borrower or the creditor, or by obtaining a nontraditional mortgage credit report from a consumer reporting agency.

#### **Rental Payment History**

The borrower's rental payment history must be documented for the most recent consecutive 12-month period. The following documentation is acceptable:

- Canceled checks can be provided. In lieu of canceled checks, the lender may use the borrower's bank statements, copies of money orders, or other reasonable methods for documenting the timely payment of rent. The documentation must clearly indicate the payee and amount being paid, and reflect that payments were made on a consistent basis.
- Direct verification of the payment of rent from the landlord. Direct landlord verification is acceptable whether the landlord is an individual or a professional management company.

If at least one borrower on the loan can document a rental housing payment as a source of nontraditional credit, the loan has met the rental payment history requirement. The lender is not required to obtain documentation of a rental payment history for other nontraditional credit borrowers on the loan. However, the lender must still document the minimum number of nontraditional credit sources required for each nontraditional credit borrower.

If two or more borrowers on a loan share the housing-related source (for example, they are both named on the lease for the property in which they are living), that documentation counts as one source of nontraditional credit documentation for each borrower, even if only one borrower has been making the payments.

**Note:** If the credit report contains a rental payment reference and it includes the required information, including payment history, then the lender may use that rental payment reference as an acceptable nontraditional credit reference.

#### **Standards for Individual Credit References Obtained Directly from a Creditor**

Individual credit references (other than rental housing payments) from a creditor must include the following:

- the creditor's name,
- the name of the individual providing the reference,
- the date the account was opened,
- the amount of highest credit,
- the current status of the account,
- the required payment amount,
- the unpaid balance, and
- the payment history.

The historical status of each account must be stated in a "number of times past due" format using "0 X 30, 0 X 60, 0 X 90" days late.

**Note:** Vague statements such as "current," "satisfactory," or "pays as agreed" are not acceptable by themselves.

#### **Standards for Documenting Payment History Obtained From the Borrower**

For documentation obtained directly from the borrower, the following standards must be met:

- documentation that describes the terms of the debt repayment or contract together with canceled checks or copies of bills marked "paid" that reflect the borrower's payment history over the most recent consecutive 12 months.
- withdrawals or debits on the borrower's bank statements that show the payee information clearly listed for the creditor and that payments were made on a consistent basis over the most recent consecutive 12 months.

#### **Verification of Bank Accounts and Wire Remittance Statements**

Account statements can be used to document the borrower's checking account, savings account, voluntary payments made to a payroll savings plan, or contributions to a stock purchase plan. The account statements must reflect an increasing balance as a result of periodic

deposits over at least the most recent consecutive 12-month period, with contributions being made no less than quarterly. If the account statements demonstrate overdraft activity, that information suggests a weakness in the borrower's ability to meet financial obligations. The lender must assess the significance of this information relative to the borrower's overall credit risk.

Wire remittance statements can be used to document a source of nontraditional credit, provided they demonstrate a consistent amount of funds being remitted over the most recent consecutive 12-month period.

### Borrowers with Disabilities

If a borrower with disabilities does not have a credit score and a nontraditional credit history is being developed, the lender may use documentation provided by a court-appointed guardian, a Social Security Administration (SSA) representative payee, or a parent, provided that this party:

- manages the borrower's financial transactions,
- maintains records on the borrower's behalf, and
- uses credit accounts held jointly in the name of the person with disabilities to pay financial obligations.

The lender can use the documentation provided either to request a nontraditional mortgage credit report from a consumer reporting agency, or to establish a nontraditional credit history for the borrower, as described in this topic.

### Non-U.S. Citizen and Foreign Borrowers

If a non-U.S. citizen or foreign borrower lacks sufficient credit references in the United States to satisfy Fannie Mae requirements, the lender must use credit references from foreign countries to achieve the required number of nontraditional credit references and establish a nontraditional credit profile.

### Assessment of the Payment History for Nontraditional Credit Sources

For each nontraditional credit source, the following requirements must be met:

- There cannot be any delinquency on rental housing payments within the past 12 months.
- Only one account, excluding rental housing payments, can have a 30-day delinquency in the past 12 months.
- No collections (other than medical collections) or judgments have been filed in the past 24 months.
- Judgments, liens, collections, and charge-offs of non-mortgage accounts must be satisfied in accordance with B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018) (for manually underwritten loans), or B3-5.3-09, DU Credit Report Analysis (12/04/2019) (for loans underwritten with DU).

**Note:** A borrower may lack sufficient credit to obtain a credit score. However, the lender must still consider any derogatory credit references that appear on the credit report.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2016-07	August 30, 2016

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > Liability Assessment

### Liability Assessment

#### Introduction

This chapter describes liability assessment for qualifying, underwriting, and documentation purposes.

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-01, General Information on Liabilities (02/05/2020)

**REVISION HISTORY 06/30/2015**

**REVISION NUMBER:** 06302015      **DATE:** 06/30/2015

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-6-01, General Information on Liabilities (06/30/2015)

#### Introduction

This topic contains information on liabilities, including:

- General Information on Liabilities
- Monthly Obligations Not Included in Liabilities

#### General Information on Liabilities

The lender's risk analysis must include all liabilities affecting income or assets that will affect the borrower's ability to fulfill the mortgage payment obligation.

A borrower's liabilities include the following:

- housing expense on the borrower's principal residence,
- all revolving charge accounts,
- installment loan debts with a remaining payment term greater than 10 months,
- lease payments,
- real estate loans,

- HELOCs,
- alimony and child support,
- maintenance payments, and
- all other debts of a recurring nature.

For each liability, the lender must determine the unpaid balance, the terms of repayment, and the borrower's payment history, and verify any other liability that is not shown on a credit report by obtaining documentation from the borrower or creditor.

If the credit report does not contain a reference for each significant open debt shown on the loan application—including outstanding mortgage debt, bank, student, or credit union loans—the lender must provide separate credit verification.

If a current liability appears on the credit report that is not shown on the loan application, the borrower should provide a reasonable explanation for the undisclosed debt. Documentation may be required to support the borrower's explanation.

If the borrower discloses, or the lender discovers, additional liabilities after the underwriting decision has been made, up to and concurrent with closing, the lender must recalculate the borrower's debt-to-income ratio. (See B3-6-02, Debt-to-Income Ratios (08/07/2019), for additional information.)

### Monthly Obligations Not Included in Liabilities

Some obligations, often identified on a borrower's paystub, are not considered a liability and will not be included as a debt or deducted from the borrower's gross income when calculating the borrower's debt-to-income ratio. These obligations include items such as

- 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; and
- voluntary deductions.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-11	August 13, 2010
Announcement SEL-2010-01	March 2, 2010

### B3-6-01, General Information on Liabilities (02/05/2020)

#### Introduction

This topic contains information on liabilities, including:

- General Information on Liabilities
- Monthly Obligations Not Included in Liabilities

#### General Information on Liabilities

The lender's risk analysis must include all liabilities affecting income or assets that will affect the borrower's ability to fulfill the mortgage payment obligation.

A borrower's liabilities include the following:

- housing payment (mortgage or rent) for each borrower's principal residence,
- all revolving charge accounts,
- installment loan debts with a remaining payment term greater than 10 months,
- lease payments,
- real estate loans,
- HELOCs,
- alimony and child support,
- maintenance payments, and
- all other debts of a recurring nature.

For each liability, the lender must determine the unpaid balance, the terms of repayment, and the borrower's payment history, and verify any other liability that is not shown on a credit report by obtaining documentation from the borrower or creditor.

If the credit report does not contain a reference for each significant open debt shown on the loan application—including outstanding mortgage debt, bank, student, or credit union loans—the lender must provide separate credit verification.

If a current liability appears on the credit report that is not shown on the loan application, the borrower should provide a reasonable explanation for the undisclosed debt. Documentation may be required to support the borrower's explanation.

If the borrower discloses, or the lender discovers, additional liabilities after the underwriting decision has been made, up to and concurrent with closing, the lender must recalculate the borrower's debt-to-income ratio.

See B3-6-02, Debt-to-Income Ratios (02/05/2020) and B3-6-03, Monthly Housing Expense for the Subject Property (12/16/2020) for additional information.

## Monthly Obligations Not Included in Liabilities

Some obligations, often identified on a borrower's paystub, are not considered a liability and will not be included as a debt or deducted from the borrower's gross income when calculating the borrower's debt-to-income ratio. These obligations include items such as

- 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; and
- voluntary deductions.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-11	August 13, 2010
Announcement SEL-2010-01	March 2, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-02, Debt-to-Income Ratios (02/05/2020)

### REVISION HISTORY 08/07/2019

REVISION NUMBER: 08072019 DATE: 08/07/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-6-02, Debt-to-Income Ratios (08/07/2019)

### Introduction

This topic contains information on the use of the debt-to-income (DTI) ratio, including:

- DTI Ratios
- Maximum DTI Ratios
- Exceptions to the Maximum DTI Ratio
- Calculating Total Monthly Obligation
- DTI Ratio Tolerance and Re-Underwriting Criteria
- Applying the Re-underwriting Criteria

For additional information, see B3-1-01, Comprehensive Risk Assessment .

### DTI Ratios

The DTI ratio consists of two components:

- total monthly obligations, which includes the qualifying payment for the subject mortgage loan and other long-term and significant short-term monthly debts (see Calculating Total Monthly Obligation below); and
- total monthly income of all borrowers, to the extent the income is used to qualify for the mortgage (see Chapter B3-3, Income Assessment).

### Maximum DTI Ratios

For manually underwritten loans, Fannie Mae's maximum total DTI ratio is 36% of the borrower's stable monthly income. The maximum can be exceeded up to 45% if the borrower meets the credit score and reserve requirements reflected in the Eligibility Matrix.

For loan casefiles underwritten through DU, the maximum allowable DTI ratio is 50%.

### Exceptions to the Maximum DTI Ratio

Fannie Mae makes exceptions to the maximum allowable DTI ratios for particular mortgage transactions, including:

- cash-out refinance transactions — the maximum ratio may be lower for loan casefiles underwritten through DU (see B2-1.2-03, Cash-Out Refinance Transactions (07/03/2019));
- high LTV refinance transactions - except for loans underwritten under the Alternative Qualification Path, there are no maximum DTI ratio requirements (see B5-7-01, High LTV Refinance Loan and Borrower Eligibility (08/07/2018));
- borrowers who do not have a credit score — the maximum ratio may be lower for manually underwritten loans and DU loan casefiles (see B3-5.4-01, Eligibility Requirements for Loans with Nontraditional Credit (12/19/2017));
- non-occupant borrowers — the maximum ratio is lower than 45% for the occupying borrower for manually underwritten loans (see B2-2-04, Guarantors, Co-Signers, or Non-Occupant Borrowers on the Subject Transaction (06/05/2018)); and
- government mortgage loans — lenders must follow the requirements for the respective government agency.

### Calculating Total Monthly Obligation

The total monthly obligation is the sum of the following:

- the monthly housing expense of the borrower's principal residence (or the qualifying payment amount if the subject mortgage loan is secured by the borrower's principal residence (see B3-6-03, Monthly Housing Expense (12/04/2019)));
- the qualifying payment amount if the subject mortgage loan is secured by a second home or investment property (see B3-6-04, Qualifying Payment Requirements (04/15/2014));
- monthly payments on installment debts and other mortgage debts that extend beyond ten months;
- monthly payments on installment debts and other mortgage debts that extend ten months or less if the payments significantly affect the borrower's ability to meet credit obligations;
- monthly payments on revolving debts;
- monthly payments on lease agreements, regardless of the expiration date of the lease;
- monthly alimony, child support, or maintenance payments that extend beyond ten months (alimony (but not child support or maintenance) may instead be deducted from income, see B3-6-05, Monthly Debt Obligations (12/04/2019));
- monthly payments for other recurring monthly obligations; and
- any net loss from a rental property.

**Note:** Fannie Mae acknowledges that lenders may sometimes apply a more conservative approach when qualifying borrowers. This is acceptable as long as Fannie Mae's minimum requirements are met, and lenders consistently apply the same approach to similar loans. For example, a lender might calculate a higher minimum payment on a credit card account than what Fannie Mae requires, which is acceptable as long as the lender consistently applies this calculation to all mortgage applications with revolving debts.

### DTI Ratio Tolerance and Re-Underwriting Criteria

Fannie Mae expects lenders to have in place processes to facilitate borrower disclosure of changes in financial circumstances throughout the origination process and prefunding quality control processes to increase the likelihood of discovering material undisclosed debts or reduced income. See D1-2-01, Lender Prefunding Quality Control Review Process (03/28/2017).

As a result of the lender's normal processes and controls, the lender may need to re-underwrite the loan after initial underwriting. If the borrower discloses or the lender discovers additional debt(s) or reduced income after the underwriting decision was made up to and concurrent with loan closing, the loan must be re-underwritten if the new information causes the DTI ratio to increase by more than the allowed tolerances.

In all cases, if the lender determines that there is new subordinate financing on the subject property during the loan process, the mortgage loan must be re-underwritten.

**Note:** Re-underwriting means that loan casefiles must be resubmitted to DU with updated information; and for manually underwritten loans, a comprehensive risk and eligibility assessment must be performed.

### Applying the Re-underwriting Criteria

The following steps are required if the borrower discloses or the lender discovers additional debt(s) or reduced income after the underwriting decision was made up to and concurrent with loan closing:

Step	Description
1	The lender must document the additional debt(s) and reduced income in accordance with B3-6-01, General Information on Liabilities (06/30/2015) or Chapter B3-3, Income Assessment, as applicable. Note: The lender is not required to obtain a new credit report to verify the additional debt(s). However, if the lender chooses to obtain a new credit report after the initial underwriting decision was made, the loan must be re-underwritten.
2	If there is new subordinate debt on the subject property, the mortgage loan must be re-underwritten.
3	The lender must recalculate the DTI ratio. For DU loan casefiles, the DTI ratio should be recalculated outside of DU.
4	<ul style="list-style-type: none"> <li>• If the recalculated DTI ratio exceeds 45% for a manually underwritten loan or 50% for a DU loan casefile, the loan is not eligible for delivery to Fannie Mae.</li> <li>• Manually underwritten loans: If the recalculated DTI does not exceed 45%, the mortgage loan must be re-underwritten with the updated information to determine if the loan is still eligible for delivery. Note: If the increase in the DTI ratio moves the DTI ratio above the 36% threshold, the loan must meet the credit score and reserve requirements in the Eligibility Matrix that apply to DTI ratios greater than 36% up to 45%.</li> <li>• DU loan casefiles: See B3-2-10, Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report (12/04/2019) for the tolerances and resubmission requirements associated with changes impacting the DTI.</li> <li>• High LTV refinance loans: For loans underwritten in accordance with the Alternative Qualification Path, if the recalculated DTI ratio exceeds 45%, the loan is not eligible for delivery to Fannie Mae. If the DTI does not exceed 45%, but is increasing by 3 or more percentage points, the loan must be re-underwritten with the updated information to determine if the loan is still eligible for delivery.</li> </ul>
5	The final loan application signed by the borrower must include all income and debts verified, disclosed, or identified during the mortgage process.
6	Upon delivery to Fannie Mae, the lender must deliver the qualifying monthly income and expense amounts that are on the final loan application. See C1-2-02, Loan Data and Documentation Delivery Requirements (12/04/2019).

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2019-04	May 01, 2019
Announcement SEL-2018-09	December 04, 2018

Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-06	May 26, 2015
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2012-10	October 2, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2011-12	November 15, 2011
Announcement SEL-2010-13	September 20, 2010
Announcement -2008-35	December 18, 2008

## B3-6-02, Debt-to-Income Ratios (02/05/2020)

### Introduction

This topic contains information on the use of the debt-to-income (DTI) ratio, including:

- DTI Ratios
- Maximum DTI Ratios
- Exceptions to the Maximum DTI Ratio
- Calculating Total Monthly Obligation
- DTI Ratio Tolerance and Re-Underwriting Criteria
- Applying the Re-underwriting Criteria

### DTI Ratios

The DTI ratio consists of two components:

- total monthly obligations, which includes the qualifying payment for the subject mortgage loan and other long-term and significant short-term monthly debts (see Calculating Total Monthly Obligation below); and
- total monthly income of all borrowers, to the extent the income is used to qualify for the mortgage (see Chapter B3-3, Income Assessment).

### Maximum DTI Ratios

For manually underwritten loans, Fannie Mae's maximum total DTI ratio is 36% of the borrower's stable monthly income. The maximum can be exceeded up to 45% if the borrower meets the credit score and reserve requirements reflected in the Eligibility Matrix.

For loan casefiles underwritten through DU, the maximum allowable DTI ratio is 50%.

See B3-1-01, Comprehensive Risk Assessment (12/16/2020) for information about the DTI.

### Exceptions to the Maximum DTI Ratio

Fannie Mae makes exceptions to the maximum allowable DTI ratios for particular mortgage transactions, including:

- cash-out refinance transactions — the maximum ratio may be lower for loan casefiles underwritten through DU (see B2-1.3-03, Cash-Out Refinance Transactions (10/07/2020));
- high LTV refinance transactions - except for loans underwritten under the Alternative Qualification Path, there are no maximum DTI ratio requirements (see B5-7-01, High LTV Refinance Loan and Borrower Eligibility (08/07/2018));
- borrowers who do not have a credit score — the maximum ratio may be lower for manually underwritten loans and DU loan casefiles (see B3-5.4-01, Eligibility Requirements for Loans with Nontraditional Credit (12/19/2017));
- non-occupant borrowers — the maximum ratio is lower than 45% for the occupying borrower for manually underwritten loans (see B2-2-04, Guarantors, Co-Signers, or Non-Occupant Borrowers on the Subject Transaction (09/02/2020)); and
- government mortgage loans — lenders must follow the requirements for the respective government agency.

### Calculating Total Monthly Obligation

The total monthly obligation is the sum of the following:

- the housing payment for each borrower's principal residence
  - if the subject loan is the borrower's principal residence, use the PITIA and qualifying payment amount (see B3-6-03, Monthly Housing Expense for the Subject Property (12/16/2020));
  - if there is a non-occupant borrower, use the mortgage payment (including HOA fees and subordinate lien payments) or rental payments (see B3-6-05, Monthly Debt Obligations (12/16/2020));
  - if the subject loan is a second home or investment property, use the mortgage payment (including HOA fees and subordinate lien payments) or rental payments (see B3-6-05, Monthly Debt Obligations (12/16/2020));
- the qualifying payment amount if the subject loan is for a second home or investment property (see B3-6-04, Qualifying Payment Requirements (04/15/2014));
- monthly payments on installment debts and other mortgage debts that extend beyond ten months;
- monthly payments on installment debts and other mortgage debts that extend ten months or less if the payments significantly affect the borrower's ability to meet credit obligations;

- monthly payments on revolving debts;
- monthly payments on lease agreements, regardless of the expiration date of the lease;
- monthly alimony, child support, or maintenance payments that extend beyond ten months (alimony (but not child support or maintenance) may instead be deducted from income, (see B3-6-05, Monthly Debt Obligations (12/16/2020));
- monthly payments for other recurring monthly obligations; and
- any net loss from a rental property.

**Note:** Fannie Mae acknowledges that lenders may sometimes apply a more conservative approach when qualifying borrowers. This is acceptable as long as Fannie Mae's minimum requirements are met, and lenders consistently apply the same approach to similar loans. For example, a lender might calculate a higher minimum payment on a credit card account than what Fannie Mae requires, which is acceptable as long as the lender consistently applies this calculation to all mortgage applications with revolving debts.

### DTI Ratio Tolerance and Re-Underwriting Criteria

Fannie Mae expects lenders to have in place processes to facilitate borrower disclosure of changes in financial circumstances throughout the origination process and prefunding quality control processes to increase the likelihood of discovering material undisclosed debts or reduced income. See D1-2-01, Lender Prefunding Quality Control Review Process (03/28/2017).

As a result of the lender's normal processes and controls, the lender may need to re-underwrite the loan after initial underwriting. If the borrower discloses or the lender discovers additional debt(s) or reduced income after the underwriting decision was made up to and concurrent with loan closing, the loan must be re-underwritten if the new information causes the DTI ratio to increase by more than the allowed tolerances.

In all cases, if the lender determines that there is new subordinate financing on the subject property during the loan process, the mortgage loan must be re-underwritten.

**Note:** Re-underwriting means that loan casefiles must be resubmitted to DU with updated information; and for manually underwritten loans, a comprehensive risk and eligibility assessment must be performed.

### Applying the Re-underwriting Criteria

The following steps are required if the borrower discloses or the lender discovers additional debt(s) or reduced income after the underwriting decision was made up to and concurrent with loan closing:

Step	Description
1	The lender must document the additional debt(s) and reduced income in accordance with B3-6-01, General Information on Liabilities (02/05/2020) or Chapter B3-3, Income Assessment, as applicable. Note: The lender is not required to obtain a new credit report to verify the additional debt(s). However, if the lender chooses to obtain a new credit report after the initial underwriting decision was made, the loan must be re-underwritten.
2	If there is new subordinate debt on the subject property, the mortgage loan must be re-underwritten.
3	The lender must recalculate the DTI ratio. For DU loan casefiles, the DTI ratio should be recalculated outside of DU.
4	<ul style="list-style-type: none"> <li>• If the recalculated DTI ratio exceeds 45% for a manually underwritten loan or 50% for a DU loan casefile, the loan is not eligible for delivery to Fannie Mae.</li> <li>• Manually underwritten loans: If the recalculated DTI does not exceed 45%, the mortgage loan must be re-underwritten with the updated information to determine if the loan is still eligible for delivery. Note: If the increase in the DTI ratio moves the DTI ratio above the 36% threshold, the loan must meet the credit score and reserve requirements in the Eligibility Matrix that apply to DTI ratios greater than 36% up to 45%.</li> <li>• DU loan casefiles: See B3-2-10, Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report (12/04/2019) for the tolerances and resubmission requirements associated with changes impacting the DTI.</li> <li>• High LTV refinance loans: For loans underwritten in accordance with the Alternative Qualification Path, if the recalculated DTI ratio exceeds 45%, the loan is not eligible for delivery to Fannie Mae. If the DTI does not exceed 45%, but is increasing by 3 or more percentage points, the loan must be re-underwritten with the updated information to determine if the loan is still eligible for delivery.</li> </ul>
5	The final loan application signed by the borrower must include all income and debts verified, disclosed, or identified during the mortgage process.
6	Upon delivery to Fannie Mae, the lender must deliver the qualifying monthly income and expense amounts that are on the final loan application. See C1-2-02, Loan Data and Documentation Delivery Requirements (12/04/2018).

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-07	August 07, 2019
Announcement SEL-2019-04	May 01, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2016-07	August 30, 2016
Announcement SEL-2015-10	September 29, 2015
Announcement SEL-2015-06	May 26, 2015

Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2012-10	October 2, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement SEL-2011-13	December 20, 2011
Announcement SEL-2011-12	November 15, 2011
Announcement SEL-2010-13	September 20, 2010
Announcement 08-35	December 18, 2008

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-03, Monthly Housing Expense for the Subject Property (12/16/2020)

**REVISION HISTORY 04/01/2020**

**REVISION NUMBER:** 04012020      **DATE:** 04/01/2020

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

## B3-6-03, Monthly Housing Expense for the Subject Property (04/01/2020)

### Introduction

This topic contains information about the following:

- Monthly Housing Expense
- Calculating Monthly Real Estate Tax Payment

### Monthly Housing Expense

Monthly housing expense is the sum of the following and is referred to as PITIA for the subject property:

- principal and interest (P&I);
- property, flood, and mortgage insurance premiums (as applicable);
- real estate taxes;
- ground rent;
- special assessments;
- any owners' association dues (including utility charges that are attributable to the common areas, but excluding any utility charges that apply to the individual unit);
- any monthly co-op corporation fee (less the *pro rata* share of the master utility charges for servicing individual units that is attributable to the borrower's unit);
- any subordinate financing payments on mortgages secured by the subject property.

**Note:** The monthly payment of a subordinate lien associated with a business debt secured by the subject property can be excluded from the monthly housing expense if it meets the requirements of *Business Debt in the Borrower's Name* in B3-6-05, Monthly Debt Obligations (02/05/2020).

Lenders must enter all components of the monthly housing expense on the application including other financing P&I, property insurance, real estate taxes, mortgage insurance, homeowners' association dues, and other proposed housing expenses.

If the subject mortgage is secured by the borrower's principal residence, the monthly housing expense is based on the qualifying payment required in accordance with B3-6-04, Qualifying Payment Requirements (04/15/2014). This amount is the monthly housing expense used to calculate the debt-to-income (DTI) ratio.

If the subject mortgage is secured by a second home or an investment property, the qualifying payment amount is considered one of the borrower's monthly debt obligations when calculating the DTI ratio.

### Calculating Monthly Real Estate Tax Payment

The lender must base its calculation of real estate taxes for borrower qualification on no less than the current assessed value. However, the lender must project the real estate taxes if one of the following applies:

- For purchase and construction-related transactions, the lender must use a reasonable estimate of the real estate taxes based on the value of the land and the total of all new and existing improvements. This policy also applies to properties in jurisdictions where a transfer of ownership typically results in a reassessment or revaluation of the property and a corresponding increase in the amount of taxes.
- There is a tax abatement on the subject property that will last for no less than 5 years from the note date. For example:
  - for a municipality with a 10-year abatement, the lender may qualify the borrower with the reduced tax amount;
  - for a municipality with a 10-year abatement and with annual real estate tax increases in years 1 through 10, the lender must qualify the borrower with the annual taxes that will be required at the end of the 5<sup>th</sup> year after the first mortgage payment date.

The lender has the option to project the real estate taxes if the amount of taxes will be reduced based on federal, state, or local jurisdictional requirements. However, the taxes may not be reduced if an appeal to reduce them is only pending and has not been approved.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-02	April 01, 2020
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-09	December 04, 2019

Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement -2009-02	February 6, 2009

**REVISION HISTORY 02/05/2020**

**REVISION NUMBER:** 02052020      **DATE:** 02/05/2020

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

**B3-6-03, Monthly Housing Expense for the Subject Property (02/05/2020)**

**Introduction**

This topic contains information about the following:

- Monthly Housing Expense
- Calculating Monthly Real Estate Tax Payment

**Monthly Housing Expense**

Monthly housing expense is the sum of the following and is referred to as PITIA for the subject property:

- principal and interest (P&I);
- property, flood, and mortgage insurance premiums (as applicable);
- real estate taxes;
- ground rent;
- special assessments;
- any owners' association dues (including utility charges that are attributable to the common areas, but excluding any utility charges that apply to the individual unit);
- any monthly co-op corporation fee (less the *pro rata* share of the master utility charges for servicing individual units that is attributable to the borrower's unit);
- any subordinate financing payments on mortgages secured by the subject property.

**Note:** The monthly payment of a subordinate lien associated with a business debt secured by the subject property can be excluded from the monthly housing expense if it meets the requirements of *Business Debt in the Borrower's Name* in B3-6-05, Monthly Debt Obligation (02/05/2020).

Lenders must enter all components of the monthly housing expense on the application including other financing P&I, property insurance, real estate taxes, mortgage insurance, homeowners' association dues, and other proposed housing expenses.

If the subject mortgage is secured by the borrower's principal residence, the monthly housing expense is based on the qualifying payment required in accordance with B3-6-04, Qualifying Payment Requirements (04/15/2014). This amount is the monthly housing expense used to calculate the debt-to-income (DTI) ratio.

If the subject mortgage is secured by a second home or an investment property, the qualifying payment amount is considered one of the borrower's monthly debt obligations when calculating the DTI ratio.

**Calculating Monthly Real Estate Tax Payment**

The lender must base its calculation of real estate taxes for borrower qualification (and escrow account purposes) on no less than the current assessed value. (The taxes are listed on the title commitment.) However, the lender must project the real estate taxes if one of the following applies:

- For purchase and construction-related transactions, the lender must use a reasonable estimate of the real estate taxes based on the value of the land and the total of all new and existing improvements. This policy also applies to properties in jurisdictions where a transfer of ownership may result in an increase in the amount of taxes.
- There is a tax abatement on the subject property that will last for no less than 5 years from the note date. For example:
  - for a municipality with a 10-year abatement, the lender may qualify the borrower with the reduced tax amount;
  - for a municipality with a 10-year abatement and with annual real estate tax increases in years 1 through 10, the lender must qualify the borrower with the annual taxes that will be required at the end of the 5<sup>th</sup> year after the first mortgage payment date.

The lender has the option to project the real estate taxes if the amount of taxes will be reduced based on federal, state, or local jurisdictional requirements. However, the taxes may not be reduced if an appeal to reduce them is only pending and has not been approved.

**Related Announcements**

The table below provides references to the Announcements that have been issued that are related to this topic.

<b>Announcements</b>	<b>Issue Date</b>
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement -2009-02	February 6, 2009

## B3-6-03, Monthly Housing Expense (12/04/2019)

### Introduction

This topic contains information about the following:

- Monthly Housing Expense
- Calculating Monthly Real Estate Tax Payment

### Monthly Housing Expense

Monthly housing expense is the sum of the following and is referred to as PITIA:

- principal and interest (P&I);
- property, flood, and mortgage insurance premiums (as applicable);
- real estate taxes;
- ground rent;
- special assessments;
- any owners' association dues (including utility charges that are attributable to the common areas, but excluding any utility charges that apply to the individual unit);
- any monthly co-op corporation fee (less the *pro rata* share of the master utility charges for servicing individual units that is attributable to the borrower's unit);
- any subordinate financing payments on mortgages secured by the subject property.

**Note:** The monthly payment of a subordinate lien associated with a business debt secured by the subject property can be excluded from the monthly housing expense if it meets the requirements of *Business Debt in the Borrower's Name* in B3-6-05, Monthly Debt Obligations (12/04/2019).

Lenders must enter all components of the monthly housing expense on the application including other financing P&I, property insurance, real estate taxes, mortgage insurance, homeowners' association dues, and other proposed housing expenses.

If the subject mortgage is secured by the borrower's principal residence, the monthly housing expense is based on the qualifying payment required in accordance with B3-6-04, Qualifying Payment Requirements (04/15/2014). This amount is the monthly housing expense used to calculate the debt-to-income (DTI) ratio.

If the subject mortgage is secured by a second home or an investment property, the qualifying payment amount is considered one of the borrower's monthly debt obligations when calculating the DTI ratio. The monthly housing expense in these cases represents the PITIA associated with the borrower's principal residence.

Refer to the Qualifying Payment Requirements for details on calculating the qualifying payment.

### Calculating Monthly Real Estate Tax Payment

The lender must base its calculation of real estate taxes for borrower qualification (and escrow account purposes) on no less than the current assessed value. (The taxes are listed on the title commitment.) However, the lender must project the real estate taxes if one of the following applies:

- For purchase and construction-related transactions, the lender must use a reasonable estimate of the real estate taxes based on the value of the land and the total of all new and existing improvements. This policy also applies to properties in jurisdictions where a transfer of ownership may result in an increase in the amount of taxes.
- There is a tax abatement on the subject property that will last for no less than 5 years from the note date. For example:
  - for a municipality with a 10-year abatement, the lender may qualify the borrower with the reduced tax amount;
  - for a municipality with a 10-year abatement and with annual real estate tax increases in years 1 through 10, the lender must qualify the borrower with the annual taxes that will be required at the end of the 5<sup>th</sup> year after the first mortgage payment date.

The lender has the option to project the real estate taxes if the amount of taxes will be reduced based on federal, state, or local jurisdictional requirements. However, the taxes may not be reduced if an appeal to reduce them is only pending and has not been approved.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement -2009-02	February 6, 2009

## B3-6-03, Monthly Housing Expense for the Subject Property (12/16/2020)

### Introduction

This topic contains information about the following:

- Monthly Housing Expense

- Calculating Monthly Real Estate Tax Payment

## Monthly Housing Expense

Monthly housing expense is the sum of the following and is referred to as PITIA for the subject property:

- principal and interest (P&I);
- property, flood, and mortgage insurance premiums (as applicable);
- real estate taxes;
- ground rent;
- special assessments;
- any owners' association dues (including utility charges that are attributable to the common areas, but excluding any utility charges that apply to the individual unit);
- any monthly co-op corporation fee (less the *pro rata* share of the master utility charges for servicing individual units that is attributable to the borrower's unit);
- any subordinate financing payments on mortgages secured by the subject property.

**Note:** The monthly payment of a subordinate lien associated with a business debt secured by the subject property can be excluded from the monthly housing expense if it meets the requirements of *Business Debt in the Borrower's Name* in B3-6-05, Monthly Debt Obligations (12/16/2020).

Lenders must enter all components of the monthly housing expense on the loan application including subordinate financing P&I, homeowner's insurance, supplemental property insurance, real estate taxes, mortgage insurance, association/project dues, and other proposed housing expenses.

If the subject mortgage is secured by the borrower's principal residence, the monthly housing expense is based on the qualifying payment required in accordance with B3-6-04, Qualifying Payment Requirements (04/15/2014). This amount is the monthly housing expense used to calculate the debt-to-income (DTI) ratio.

If the subject mortgage is secured by a second home or an investment property, the qualifying payment amount is considered one of the borrower's monthly debt obligations when calculating the DTI ratio.

## Calculating Monthly Real Estate Tax Payment

The lender must base its calculation of real estate taxes for borrower qualification on no less than the current assessed value. However, the lender must project the real estate taxes if one of the following applies:

- For purchase and construction-related transactions, the lender must use a reasonable estimate of the real estate taxes based on the value of the land and the total of all new and existing improvements. This policy also applies to properties in jurisdictions where a transfer of ownership typically results in a reassessment or revaluation of the property and a corresponding increase in the amount of taxes.
- There is a tax abatement on the subject property that will last for no less than 5 years from the note date. For example:
  - for a municipality with a 10-year abatement, the lender may qualify the borrower with the reduced tax amount;
  - for a municipality with a 10-year abatement and with annual real estate tax increases in years 1 through 10, the lender must qualify the borrower with the annual taxes that will be required at the end of the 5<sup>th</sup> year after the first mortgage payment date.

The lender has the option to project the real estate taxes if the amount of taxes will be reduced based on federal, state, or local jurisdictional requirements. However, the taxes may not be reduced if an appeal to reduce them is only pending and has not been approved.

## Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2020-02	April 01, 2020
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2013-04	May 28, 2013
Announcement SEL-2012-07	August 21, 2012
Announcement -2009-02	February 6, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-04, Qualifying Payment Requirements (04/15/2014)

## B3-6-04, Qualifying Payment Requirements (04/15/2014)

### Introduction

This topic contains information on determining the borrower's monthly PITIA used for qualifying purposes, including:

- Qualifying Payment Amount
- Additional Information About ARM Qualifying for DU Loan Casefiles
- Additional Qualifying Considerations for Specific Products

### Qualifying Payment Amount

The calculation of the qualifying payment amount for the subject property will differ based on the transaction type (as shown in the following

table).

These policies apply to both manually underwritten loans and DU loan casefiles. In all cases, qualification must consider the borrower's current obligations and other mortgage-related obligations, i.e. PITIA.

Mortgage loans subject to temporary interest rate buydowns must be qualified without consideration of the bought-down rate, based on the transaction type below.

Qualifying Interest Rate Requirements	
Transaction Type	DU and Manual Underwriting
Fixed-rate mortgages	Note rate
ARMs with an initial fixed-rate period of five years or less	Greater of the note rate plus 2% or the fully indexed rate
ARMs with an initial fixed-rate period of greater than five years	Greater of the note rate or the fully indexed rate

### Additional Information About ARM Qualifying for DU Loan Casefiles

For DU loan casefiles, the fully indexed rate is defined as the index plus the margin as entered in the online loan application. The index and margin are required for all ARM loans submitted to DU.

If "Lender ARM Plan" is used in DU, DU uses the interest rate entered in the ARM Qualifying Rate field. If no interest rate is entered in that field, DU uses the note rate plus 2% to qualify the borrower.

### Additional Qualifying Considerations for Specific Products

For additional temporary interest rate buydown requirements, see B2-1.4-04, Temporary Interest Rate Buydowns (07/29/2014).

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2014-03	April 15, 2014
Announcement SEL-2013-06	August 20, 2013
Announcement SEL-2012-07	August 21, 2012
DU Version 9.0	July 24, 2012
Announcement SEL-2012-06	June 26, 2012
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-06	April 30, 2010
Announcement -2009-32	October 30, 2009
Announcement -2009-29	September 22, 2009
Announcement -2009-24	July 10, 2009
Announcement -2009-19	June 8, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-05, Monthly Debt Obligations (12/16/2020)

**REVISION HISTORY 02/05/2020**

**REVISION NUMBER:** 02052020      **DATE:** 02/05/2020

**REVISION REMARKS:** THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

### B3-6-05, Monthly Debt Obligations (02/05/2020)

#### Introduction

This topic describes obligations that should be considered in underwriting the loan, including:

- Alimony/Child Support/Separate Maintenance Payments
- Bridge / Swing Loans
- Business Debt in Borrower's Name
- Court-Ordered Assignment of Debt
- Debts Paid by Others
- Non-Applicant Accounts
- Deferred Installment Debt
- Federal Income Tax Installment Agreements
- Garnishments
- Home Equity Lines of Credit
- Installment Debt
- Lease Payments
- Rental Housing Payment
- Loans Secured by Financial Assets

- Open 30-Day Charge Accounts
- Other Real Estate Owned—Qualifying Impact
- Revolving Charge/Lines of Credit
- Student Loans

### **Alimony/Child Support/Separate Maintenance Payments**

When the borrower is required to pay alimony, child support, or maintenance payments under a divorce decree, separation agreement, or any other written legal agreement—and those payments must continue to be made for more than ten months—the payments must be considered as part of the borrower's recurring monthly debt obligations. However, voluntary payments do not need to be taken into consideration and an exception is allowed for alimony. A copy of the divorce decree, separation agreement, court order, or equivalent documentation confirming the amount of the obligation must be obtained and retained in the loan file.

For alimony obligations, the lender has the option to reduce the qualifying income by the amount of the alimony obligation in lieu of including it as a monthly payment in the calculation of the DTI ratio.

**Note:** For loan casefiles underwritten through DU, when using the option of reducing the borrower's monthly qualifying income by the monthly alimony payment, under *Income Type*, the lender must enter the amount of the alimony obligation as a negative amount. If the borrower also receives alimony income, this amount should be combined with the amount of the alimony payment and entered as a net amount.

### **Bridge / Swing Loans**

When a borrower obtains a bridge (or swing) loan, the funds from that loan can be used for closing on a new principal residence before the current residence is sold. This creates a contingent liability that must be considered part of the borrower's recurring monthly debt obligations and included in the DTI ratio calculation.

Fannie Mae will waive this requirement and not require the debt to be included in the DTI ratio if the following documentation is provided:

- a fully executed sales contract for the current residence, and
- confirmation that any financing contingencies have been cleared.

### **Business Debt in Borrower's Name**

When a self-employed borrower claims that a monthly obligation that appears on his or her personal credit report (such as a Small Business Administration loan) is being paid by the borrower's business, the lender must confirm that it verified that the obligation was actually paid out of company funds and that this was considered in its cash flow analysis of the borrower's business.

The account payment does not need to be considered as part of the borrower's DTI ratio if:

- the account in question does not have a history of delinquency,
- the business provides acceptable evidence that the obligation was paid out of company funds (such as 12 months of canceled company checks), and
- the lender's cash flow analysis of the business took payment of the obligation into consideration.

The account payment must be considered as part of the borrower's DTI ratio in any of the following situations:

- If the business does not provide sufficient evidence that the obligation was paid out of company funds.
- If the business provides acceptable evidence of its payment of the obligation, but the lender's cash flow analysis of the business does not reflect any business expense related to the obligation (such as an interest expense—and taxes and insurance, if applicable—equal to or greater than the amount of interest that one would reasonably expect to see given the amount of financing shown on the credit report and the age of the loan). It is reasonable to assume that the obligation has not been accounted for in the cash flow analysis.
- If the account in question has a history of delinquency. To ensure that the obligation is counted only once, the lender should adjust the net income of the business by the amount of interest, taxes, or insurance expense, if any, that relates to the account in question.

### **Court-Ordered Assignment of Debt**

When a borrower has outstanding debt that was assigned to another party by court order (such as under a divorce decree or separation agreement) and the creditor does not release the borrower from liability, the borrower has a contingent liability. The lender is not required to count this contingent liability as part of the borrower's recurring monthly debt obligations.

The lender is not required to evaluate the payment history for the assigned debt after the effective date of the assignment. The lender cannot disregard the borrower's payment history for the debt before its assignment.

### **Debts Paid by Others**

Certain debts can be excluded from the borrower's recurring monthly obligations and the DTI ratio:

- When a borrower is obligated on a non-mortgage debt - but is not the party who is actually repaying the debt - the lender may exclude the monthly payment from the borrower's recurring monthly obligations. This policy applies whether or not the other party is obligated on the debt, but is not applicable if the other party is an interested party to the subject transaction (such as the seller or realtor). Non-mortgage debts include installment loans, student loans, revolving accounts, lease payments, alimony, child support, and separate maintenance. See below for treatment of payments due under a federal income tax installment agreement.
- When a borrower is obligated on a mortgage debt - but is not the party who is actually repaying the debt - the lender may exclude the full monthly housing expense (PITIA) from the borrower's recurring monthly obligations if
  - the party making the payments is obligated on the mortgage debt,
  - there are no delinquencies in the most recent 12 months, and
  - the borrower is not using rental income from the applicable property to qualify.

In order to exclude non-mortgage or mortgage debts from the borrower's DTI ratio, the lender must obtain the most recent 12 months' canceled checks (or bank statements) from the other party making the payments that document a 12-month payment history with no delinquent payments.

When a borrower is obligated on a mortgage debt, regardless of whether or not the other party is making the monthly mortgage payments, the referenced property must be included in the count of financed properties (if applicable per B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019)).

## Non-Applicant Accounts

Credit reports may include accounts identified as possible non-applicant accounts (or with other similar notation). Non-applicant accounts may belong to the borrower, or they may truly belong to another individual.

Typical causes of non-applicant accounts include:

- applicants who are Juniors or Seniors,
- individuals who move frequently,
- unrelated individuals who have identical names, and
- debts the borrower applied for under a different Social Security number or under a different address. These may be indicative of potential fraud.

If the debts do not belong to the borrower, the lender may provide supporting documentation to validate this, and may exclude the non-applicant debts for the borrower's DTI ratio. If the debts do belong to the borrower, they must be included as part of the borrower's recurring monthly debt obligations.

## Deferred Installment Debt

Deferred installment debts must be included as part of the borrower's recurring monthly debt obligations. For deferred installment debts other than student loans, if the borrower's credit report does not indicate the monthly amount that will be payable at the end of the deferment period, the lender must obtain copies of the borrower's payment letters or forbearance agreements so that a monthly payment amount can be determined and used in calculating the borrower's total monthly obligations.

For information about deferred student loans, see Student Loans below.

## Federal Income Tax Installment Agreements

When a borrower has entered into an installment agreement with the IRS to repay delinquent federal income taxes, the lender may include the monthly payment amount as part of the borrower's monthly debt obligations (in lieu of requiring payment in full) if:

- There is no indication that a Notice of Federal Tax Lien has been filed against the borrower in the county in which the subject property is located.
- The lender obtains the following documentation:
  - an approved IRS installment agreement with the terms of repayment, including the monthly payment amount and total amount due; and
  - evidence the borrower is current on the payments associated with the tax installment plan. Acceptable evidence includes the most recent payment reminder from the IRS, reflecting the last payment amount and date and the next payment amount owed and due date. At least one payment must have been made prior to closing.

As a reminder, lenders remain responsible under the life-of-loan representations and warranties for clear title and first-lien enforceability in accordance with A2-2-07, Life-of-Loan Representations and Warranties (08/07/2019).

The payments on a federal income tax installment agreement can be excluded from the borrower's DTI ratio if the agreement meets the terms in *Debts Paid by Others or Installment Debt* described above. If any of the above conditions are not met, the borrower must pay off the outstanding balance due under the installment agreement with the IRS in accordance with B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018)

## Garnishments

All garnishments with more than ten months remaining must be included in the borrower's recurring monthly debt obligations for qualifying purposes.

## Home Equity Lines of Credit

When the mortgage that will be delivered to Fannie Mae also has a home equity line of credit (HELOC) that provides for a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the borrower's recurring monthly debt obligations. If the HELOC does not require a payment, there is no recurring monthly debt obligation so the lender does not need to develop an equivalent payment amount.

## Installment Debt

All installment debt that is not secured by a financial asset—including student loans, automobile loans, personal loans, and timeshares—must be considered part of the borrower's recurring monthly debt obligations if there are more than ten monthly payments remaining. However, an installment debt with fewer monthly payments remaining also should be considered as a recurring monthly debt obligation if it significantly affects the borrower's ability to meet his or her credit obligations. See below for treatment of payments due under a federal income tax installment agreement.

**Note:** A timeshare account should be treated as an installment debt regardless of how it is reported on the credit report or other documentation (that is, even if reported as a mortgage loan).

## Lease Payments

Lease payments must be considered as recurring monthly debt obligations regardless of the number of months remaining on the lease. This is because the expiration of a lease agreement for rental housing or an automobile typically leads to either a new lease agreement, the buyout of the existing lease, or the purchase of a new vehicle or house.

## Rental Housing Payment

The housing payment for each borrower's principal residence must be considered when underwriting the loan. For the following scenarios, the borrower's monthly rental housing payment must be evaluated (if the borrower does not otherwise have a mortgage payment or no housing expense):

- for non-occupant borrowers, and
- for second homes or investment properties.

The following list provides examples of acceptable documentation to verify the rental payment:

- six months canceled checks or equivalent payment source;
- six months bank statements reflecting a clear and consistent payment to an organization or individual;
- direct verification of rent from a management company or individual landlord; or
- a copy of a current, fully executed lease agreement and two months canceled checks (or equivalent payment source) supporting the rental payment amount.

**Note:** Refer to B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016) for rental payment history requirements when using non-traditional credit.

### Loans Secured by Financial Assets

When a borrower uses his or her financial assets—life insurance policies, 401(k) accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc.—as security for a loan, the borrower has a contingent liability.

The lender is not required to include this contingent liability as part of the borrower’s recurring monthly debt obligations provided the lender obtains a copy of the applicable loan instrument that shows the borrower’s financial asset as collateral for the loan. If the borrower intends to use the same asset to satisfy financial reserve requirements, the lender must reduce the value of the asset (the account balance, in most cases) by the proceeds from the secured loan and any related fees to determine whether the borrower has sufficient reserves.

### Open 30-Day Charge Accounts

Open 30-day charge accounts require the balance to be paid in full every month. Fannie Mae does not require open 30-day charge accounts to be included in the debt-to-income ratio.

See B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018), for additional information on open 30-day charge accounts.

### Other Real Estate Owned—Qualifying Impact

For details regarding the qualifying impact of other real estate owned, see B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

### Revolving Charge/Lines of Credit

Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long-term debts and must be considered part of the borrower’s recurring monthly debt obligations. These tradelines include credit cards, department store charge cards, and personal lines of credit. Equity lines of credit secured by real estate should be included in the housing expense.

If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment of less than 5%, the lender must use 5% of the outstanding balance as the borrower’s recurring monthly debt obligation.

For DU loan casefiles, if a revolving debt is provided on the loan application without a monthly payment amount, DU will use the greater of \$10 or 5% of the outstanding balance as the monthly payment when calculating the total debt-to-income ratio.

### Student Loans

If a monthly student loan payment is provided on the credit report, the lender may use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, the lender may 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, the lender must determine the qualifying monthly payment using one of the options below.

- If the borrower is on an income-driven payment plan, the lender may obtain student loan documentation to verify the actual monthly payment is \$0. The lender may then qualify the borrower with a \$0 payment.
- For deferred loans or loans in forbearance, the lender may 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.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-01	January 30, 2018
Announcement SEL-2017-09	October 31, 2017
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2017-04	April 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-04	May 31, 2016
Announcement SEL-2015-07	June 30, 2015

Announcement SEL-2014-16	December 16, 2014
Announcement SEL-2011-04	May 24, 2011
Announcement SEL-2010-13	September 20, 2010
Announcement -2009-32	October 30, 2009
Announcement -2009-02	February 6, 2009

**REVISION HISTORY 12/04/2019**

REVISION NUMBER: 12042019      DATE: 12/04/2019

REVISION REMARKS: THE FOLLOWING TOPIC WAS CHANGED. THE ENTIRE CONTENT IS ARCHIVED HERE PRIOR TO THE CHANGE DATE.

**B3-6-05, Monthly Debt Obligations (12/04/2019)**

**Introduction**

This topic describes obligations that should be considered in underwriting the loan, including:

- Alimony/Child Support/Separate Maintenance Payments
- Bridge / Swing Loans
- Business Debt in Borrower’s Name
- Court-Ordered Assignment of Debt
- Debts Paid by Others
- Non-Applicant Accounts
- Deferred Installment Debt
- Federal Income Tax Installment Agreements
- Garnishments
- Home Equity Lines of Credit
- Installment Debt
- Lease Payments
- Loans Secured by Financial Assets
- Open 30-Day Charge Accounts
- Other Real Estate Owned—Qualifying Impact
- Revolving Charge/Lines of Credit
- Student Loans

**Alimony/Child Support/Separate Maintenance Payments**

When the borrower is required to pay alimony, child support, or maintenance payments under a divorce decree, separation agreement, or any other written legal agreement—and those payments must continue to be made for more than ten months—the payments must be considered as part of the borrower’s recurring monthly debt obligations. However, voluntary payments do not need to be taken into consideration and an exception is allowed for alimony. A copy of the divorce decree, separation agreement, court order, or equivalent documentation confirming the amount of the obligation must be obtained and retained in the loan file.

For alimony obligations, the lender has the option to reduce the qualifying income by the amount of the alimony obligation in lieu of including it as a monthly payment in the calculation of the DTI ratio.

**Note:** For loan casefiles underwritten through DU, when using the option of reducing the borrower’s monthly qualifying income by the monthly alimony payment, under *Income Type*, the lender must enter the amount of the alimony obligation as a negative amount. If the borrower also receives alimony income, this amount should be combined with the amount of the alimony payment and entered as a net amount.

**Bridge / Swing Loans**

When a borrower obtains a bridge (or swing) loan, the funds from that loan can be used for closing on a new principal residence before the current residence is sold. This creates a contingent liability that must be considered part of the borrower’s recurring monthly debt obligations and included in the DTI ratio calculation.

Fannie Mae will waive this requirement and not require the debt to be included in the DTI ratio if the following documentation is provided:

- a fully executed sales contract for the current residence, and
- confirmation that any financing contingencies have been cleared.

**Business Debt in Borrower’s Name**

When a self-employed borrower claims that a monthly obligation that appears on his or her personal credit report (such as a Small Business Administration loan) is being paid by the borrower’s business, the lender must confirm that it verified that the obligation was actually paid out of company funds and that this was considered in its cash flow analysis of the borrower’s business.

The account payment does not need to be considered as part of the borrower’s DTI ratio if:

- the account in question does not have a history of delinquency,
- the business provides acceptable evidence that the obligation was paid out of company funds (such as 12 months of canceled company checks), and
- the lender’s cash flow analysis of the business took payment of the obligation into consideration.

The account payment must be considered as part of the borrower’s DTI ratio in any of the following situations:

- If the business does not provide sufficient evidence that the obligation was paid out of company funds.
- If the business provides acceptable evidence of its payment of the obligation, but the lender’s cash flow analysis of the business does not

reflect any business expense related to the obligation (such as an interest expense—and taxes and insurance, if applicable—equal to or greater than the amount of interest that one would reasonably expect to see given the amount of financing shown on the credit report and the age of the loan). It is reasonable to assume that the obligation has not been accounted for in the cash flow analysis.

- If the account in question has a history of delinquency. To ensure that the obligation is counted only once, the lender should adjust the net income of the business by the amount of interest, taxes, or insurance expense, if any, that relates to the account in question.

### **Court-Ordered Assignment of Debt**

When a borrower has outstanding debt that was assigned to another party by court order (such as under a divorce decree or separation agreement) and the creditor does not release the borrower from liability, the borrower has a contingent liability. The lender is not required to count this contingent liability as part of the borrower's recurring monthly debt obligations.

The lender is not required to evaluate the payment history for the assigned debt after the effective date of the assignment. The lender cannot disregard the borrower's payment history for the debt before its assignment.

### **Debts Paid by Others**

Certain debts can be excluded from the borrower's recurring monthly obligations and the DTI ratio:

- When a borrower is obligated on a non-mortgage debt - but is not the party who is actually repaying the debt - the lender may exclude the monthly payment from the borrower's recurring monthly obligations. This policy applies whether or not the other party is obligated on the debt, but is not applicable if the other party is an interested party to the subject transaction (such as the seller or realtor). Non-mortgage debts include installment loans, student loans, revolving accounts, lease payments, alimony, child support, and separate maintenance. See below for treatment of payments due under a federal income tax installment agreement.
- When a borrower is obligated on a mortgage debt - but is not the party who is actually repaying the debt - the lender may exclude the full monthly housing expense (PITIA) from the borrower's recurring monthly obligations if
  - the party making the payments is obligated on the mortgage debt,
  - there are no delinquencies in the most recent 12 months, and
  - the borrower is not using rental income from the applicable property to qualify.

In order to exclude non-mortgage or mortgage debts from the borrower's DTI ratio, the lender must obtain the most recent 12 months' canceled checks (or bank statements) from the other party making the payments that document a 12-month payment history with no delinquent payments.

When a borrower is obligated on a mortgage debt, regardless of whether or not the other party is making the monthly mortgage payments, the referenced property must be included in the count of financed properties (if applicable per B2-2-03, Multiple Financed Properties for the Same Borrower (08/07/2019)).

### **Non-Applicant Accounts**

Credit reports may include accounts identified as possible non-applicant accounts (or with other similar notation). Non-applicant accounts may belong to the borrower, or they may truly belong to another individual.

Typical causes of non-applicant accounts include:

- applicants who are Juniors or Seniors,
- individuals who move frequently,
- unrelated individuals who have identical names, and
- debts the borrower applied for under a different Social Security number or under a different address. These may be indicative of potential fraud.

If the debts do not belong to the borrower, the lender may provide supporting documentation to validate this, and may exclude the non-applicant debts for the borrower's DTI ratio. If the debts do belong to the borrower, they must be included as part of the borrower's recurring monthly debt obligations.

### **Deferred Installment Debt**

Deferred installment debts must be included as part of the borrower's recurring monthly debt obligations. For deferred installment debts other than student loans, if the borrower's credit report does not indicate the monthly amount that will be payable at the end of the deferment period, the lender must obtain copies of the borrower's payment letters or forbearance agreements so that a monthly payment amount can be determined and used in calculating the borrower's total monthly obligations.

For information about deferred student loans, see Student Loans below.

### **Federal Income Tax Installment Agreements**

When a borrower has entered into an installment agreement with the IRS to repay delinquent federal income taxes, the lender may include the monthly payment amount as part of the borrower's monthly debt obligations (in lieu of requiring payment in full) if:

- There is no indication that a Notice of Federal Tax Lien has been filed against the borrower in the county in which the subject property is located.
- The lender obtains the following documentation:
  - an approved IRS installment agreement with the terms of repayment, including the monthly payment amount and total amount due; and
  - evidence the borrower is current on the payments associated with the tax installment plan. Acceptable evidence includes the most recent payment reminder from the IRS, reflecting the last payment amount and date and the next payment amount owed and due date. At least one payment must have been made prior to closing.

As a reminder, lenders remain responsible under the life-of-loan representations and warranties for clear title and first-lien enforceability in accordance with A2-2.1-07, Life-of-Loan Representations and Warranties (08/07/2019).

The payments on a federal income tax installment agreement can be excluded from the borrower's DTI ratio if the agreement meets the terms in *Debts Paid by Others* or *Installment Debt* described above. If any of the above conditions are not met, the borrower must pay off the outstanding balance due under the installment agreement with the IRS in accordance with B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018).

## Garnishments

All garnishments with more than ten months remaining must be included in the borrower's recurring monthly debt obligations for qualifying purposes.

## Home Equity Lines of Credit

When the mortgage that will be delivered to Fannie Mae also has a home equity line of credit (HELOC) that provides for a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the borrower's recurring monthly debt obligations. If the HELOC does not require a payment, there is no recurring monthly debt obligation so the lender does not need to develop an equivalent payment amount.

## Installment Debt

All installment debt that is not secured by a financial asset—including student loans, automobile loans, personal loans, and timeshares—must be considered part of the borrower's recurring monthly debt obligations if there are more than ten monthly payments remaining. However, an installment debt with fewer monthly payments remaining also should be considered as a recurring monthly debt obligation if it significantly affects the borrower's ability to meet his or her credit obligations. See below for treatment of payments due under a federal income tax installment agreement.

**Note:** A timeshare account should be treated as an installment debt regardless of how it is reported on the credit report or other documentation (that is, even if reported as a mortgage loan).

## Lease Payments

Lease payments must be considered as recurring monthly debt obligations regardless of the number of months remaining on the lease. This is because the expiration of a lease agreement for rental housing or an automobile typically leads to either a new lease agreement, the buyout of the existing lease, or the purchase of a new vehicle or house.

## Loans Secured by Financial Assets

When a borrower uses his or her financial assets—life insurance policies, 401(k) accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc.—as security for a loan, the borrower has a contingent liability.

The lender is not required to include this contingent liability as part of the borrower's recurring monthly debt obligations provided the lender obtains a copy of the applicable loan instrument that shows the borrower's financial asset as collateral for the loan. If the borrower intends to use the same asset to satisfy financial reserve requirements, the lender must reduce the value of the asset (the account balance, in most cases) by the proceeds from the secured loan and any related fees to determine whether the borrower has sufficient reserves.

## Open 30-Day Charge Accounts

Open 30-day charge accounts require the balance to be paid in full every month. Fannie Mae does not require open 30-day charge accounts to be included in the debt-to-income ratio.

See B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018), for additional information on open 30-day charge accounts.

## Other Real Estate Owned—Qualifying Impact

For details regarding the qualifying impact of other real estate owned, see B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

## Revolving Charge/Lines of Credit

Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long-term debts and must be considered part of the borrower's recurring monthly debt obligations. These tradelines include credit cards, department store charge cards, and personal lines of credit. Equity lines of credit secured by real estate should be included in the housing expense.

If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment of less than 5%, the lender must use 5% of the outstanding balance as the borrower's recurring monthly debt obligation.

For DU loan casefiles, if a revolving debt is provided on the loan application without a monthly payment amount, DU will use the greater of \$10 or 5% of the outstanding balance as the monthly payment when calculating the total debt-to-income ratio.

## Student Loans

If a monthly student loan payment is provided on the credit report, the lender may use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, the lender may 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, the lender must determine the qualifying monthly payment using one of the options below.

- If the borrower is on an income-driven payment plan, the lender may obtain student loan documentation to verify the actual monthly payment is \$0. The lender may then qualify the borrower with a \$0 payment.
- For deferred loans or loans in forbearance, the lender may 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.

## Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2019-08	October 02, 2019

Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-01	January 30, 2018
Announcement SEL-2017-09	October 31, 2017
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2017-04	April 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-04	May 31, 2016
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Announcement SEL-2014-16	December 16, 2014
Announcement SEL-2011-04	May 24, 2011
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010
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### B3-6-05, Monthly Debt Obligations (12/16/2020)

#### Introduction

This topic describes obligations that should be considered in underwriting the loan, including:

- Alimony, Child Support, and Separate Maintenance Payments
- Bridge / Swing Loans
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- Student Loans

#### Alimony, Child Support, and Separate Maintenance Payments

When the borrower is required to pay alimony, child support, or separate maintenance payments under a divorce decree, separation agreement, or any other written legal agreement—and those payments must continue to be made for more than ten months—the payments must be considered as part of the borrower's recurring monthly debt obligations. However, voluntary payments do not need to be taken into consideration and an exception is allowed for alimony. A copy of the divorce decree, separation agreement, court order, or equivalent documentation confirming the amount of the obligation must be obtained and retained in the loan file.

For alimony and separate maintenance obligations, the lender has the option to reduce the qualifying income by the amount of the obligation in lieu of including it as a monthly payment in the calculation of the DTI ratio.

**Note:** For loan casefiles underwritten through DU, when using the option of reducing the borrower's monthly qualifying income by the alimony or separate maintenance payment, the lender must enter the amount of the monthly obligation as a negative alimony or separate maintenance income amount. (If the borrower also receives alimony or separate maintenance income, the amounts should be combined and entered as a net amount.)

#### Bridge / Swing Loans

When a borrower obtains a bridge (or swing) loan, the funds from that loan can be used for closing on a new principal residence before the current residence is sold. This creates a contingent liability that must be considered part of the borrower's recurring monthly debt obligations and included in the DTI ratio calculation.

Fannie Mae will waive this requirement and not require the debt to be included in the DTI ratio if the following documentation is provided:

- a fully executed sales contract for the current residence, and
- confirmation that any financing contingencies have been cleared.

#### Business Debt in Borrower's Name

When a self-employed borrower claims that a monthly obligation that appears on his or her personal credit report (such as a Small Business

Administration loan) is being paid by the borrower's business, the lender must confirm that it verified that the obligation was actually paid out of company funds and that this was considered in its cash flow analysis of the borrower's business.

The account payment does not need to be considered as part of the borrower's DTI ratio if:

- the account in question does not have a history of delinquency,
- the business provides acceptable evidence that the obligation was paid out of company funds (such as 12 months of canceled company checks), and
- the lender's cash flow analysis of the business took payment of the obligation into consideration.

The account payment must be considered as part of the borrower's DTI ratio in any of the following situations:

- If the business does not provide sufficient evidence that the obligation was paid out of company funds.
- If the business provides acceptable evidence of its payment of the obligation, but the lender's cash flow analysis of the business does not reflect any business expense related to the obligation (such as an interest expense—and taxes and insurance, if applicable—equal to or greater than the amount of interest that one would reasonably expect to see given the amount of financing shown on the credit report and the age of the loan). It is reasonable to assume that the obligation has not been accounted for in the cash flow analysis.
- If the account in question has a history of delinquency. To ensure that the obligation is counted only once, the lender should adjust the net income of the business by the amount of interest, taxes, or insurance expense, if any, that relates to the account in question.

### **Court-Ordered Assignment of Debt**

When a borrower has outstanding debt that was assigned to another party by court order (such as under a divorce decree or separation agreement) and the creditor does not release the borrower from liability, the borrower has a contingent liability. The lender is not required to count this contingent liability as part of the borrower's recurring monthly debt obligations.

The lender is not required to evaluate the payment history for the assigned debt after the effective date of the assignment. The lender cannot disregard the borrower's payment history for the debt before its assignment.

### **Debts Paid by Others**

Certain debts can be excluded from the borrower's recurring monthly obligations and the DTI ratio:

- When a borrower is obligated on a non-mortgage debt - but is not the party who is actually repaying the debt - the lender may exclude the monthly payment from the borrower's recurring monthly obligations. This policy applies whether or not the other party is obligated on the debt, but is not applicable if the other party is an interested party to the subject transaction (such as the seller or realtor). Non-mortgage debts include installment loans, student loans, revolving accounts, lease payments, alimony, child support, and separate maintenance. See below for treatment of payments due under a federal income tax installment agreement.
- When a borrower is obligated on a mortgage debt - but is not the party who is actually repaying the debt - the lender may exclude the full monthly housing expense (PITIA) from the borrower's recurring monthly obligations if
  - the party making the payments is obligated on the mortgage debt,
  - there are no delinquencies in the most recent 12 months, and
  - the borrower is not using rental income from the applicable property to qualify.

In order to exclude non-mortgage or mortgage debts from the borrower's DTI ratio, the lender must obtain the most recent 12 months' canceled checks (or bank statements) from the other party making the payments that document a 12-month payment history with no delinquent payments.

When a borrower is obligated on a mortgage debt, regardless of whether or not the other party is making the monthly mortgage payments, the referenced property must be included in the count of financed properties (if applicable per B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020)).

### **Non-Applicant Accounts**

Credit reports may include accounts identified as possible non-applicant accounts (or with other similar notation). Non-applicant accounts may belong to the borrower, or they may truly belong to another individual.

Typical causes of non-applicant accounts include:

- applicants who are Juniors or Seniors,
- individuals who move frequently,
- unrelated individuals who have identical names, and
- debts the borrower applied for under a different Social Security number or under a different address. These may be indicative of potential fraud.

If the debts do not belong to the borrower, the lender may provide supporting documentation to validate this, and may exclude the non-applicant debts for the borrower's DTI ratio. If the debts do belong to the borrower, they must be included as part of the borrower's recurring monthly debt obligations.

### **Deferred Installment Debt**

Deferred installment debts must be included as part of the borrower's recurring monthly debt obligations. For deferred installment debts other than student loans, if the borrower's credit report does not indicate the monthly amount that will be payable at the end of the deferment period, the lender must obtain copies of the borrower's payment letters or forbearance agreements so that a monthly payment amount can be determined and used in calculating the borrower's total monthly obligations.

For information about deferred student loans, see Student Loans below.

### **Federal Income Tax Installment Agreements**

When a borrower has entered into an installment agreement with the IRS to repay delinquent federal income taxes, the lender may include the monthly payment amount as part of the borrower's monthly debt obligations (in lieu of requiring payment in full) if:

- There is no indication that a Notice of Federal Tax Lien has been filed against the borrower in the county in which the subject property is located.
- The lender obtains the following documentation:

- an approved IRS installment agreement with the terms of repayment, including the monthly payment amount and total amount due; and
- evidence the borrower is current on the payments associated with the tax installment plan. Acceptable evidence includes the most recent payment reminder from the IRS, reflecting the last payment amount and date and the next payment amount owed and due date. At least one payment must have been made prior to closing.

As a reminder, lenders remain responsible under the life-of-loan representations and warranties for clear title and first-lien enforceability in accordance with A2-2-07, Life-of-Loan Representations and Warranties (08/07/2019).

The payments on a federal income tax installment agreement can be excluded from the borrower's DTI ratio if the agreement meets the terms in *Debts Paid by Others* or *Installment Debt* described above. If any of the above conditions are not met, the borrower must pay off the outstanding balance due under the installment agreement with the IRS in accordance with B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018)

### **Garnishments**

All garnishments with more than ten months remaining must be included in the borrower's recurring monthly debt obligations for qualifying purposes.

### **Home Equity Lines of Credit**

When the mortgage that will be delivered to Fannie Mae also has a home equity line of credit (HELOC) that provides for a monthly payment of principal and interest or interest only, the payment on the HELOC must be considered as part of the borrower's recurring monthly debt obligations. If the HELOC does not require a payment, there is no recurring monthly debt obligation so the lender does not need to develop an equivalent payment amount.

### **Installment Debt**

All installment debt that is not secured by a financial asset—including student loans, automobile loans, personal loans, and timeshares—must be considered part of the borrower's recurring monthly debt obligations if there are more than ten monthly payments remaining. However, an installment debt with fewer monthly payments remaining also should be considered as a recurring monthly debt obligation if it significantly affects the borrower's ability to meet his or her credit obligations. See below for treatment of payments due under a federal income tax installment agreement.

**Note:** A timeshare account should be treated as an installment debt regardless of how it is reported on the credit report or other documentation (that is, even if reported as a mortgage loan).

### **Lease Payments**

Lease payments must be considered as recurring monthly debt obligations regardless of the number of months remaining on the lease. This is because the expiration of a lease agreement for rental housing or an automobile typically leads to either a new lease agreement, the buyout of the existing lease, or the purchase of a new vehicle or house.

### **Rental Housing Payment**

The housing payment for each borrower's principal residence must be considered when underwriting the loan. For the following scenarios, the borrower's monthly rental housing payment must be evaluated (if the borrower does not otherwise have a mortgage payment or no housing expense):

- for non-occupant borrowers, and
- for second homes or investment properties.

The following list provides examples of acceptable documentation to verify the rental payment:

- six months canceled checks or equivalent payment source;
- six months bank statements reflecting a clear and consistent payment to an organization or individual;
- direct verification of rent from a management company or individual landlord; or
- a copy of a current, fully executed lease agreement and two months canceled checks (or equivalent payment source) supporting the rental payment amount.

**Note:** Refer to B3-5.4-03, Documentation and Assessment of a Nontraditional Credit History (08/30/2016) for rental payment history requirements when using non-traditional credit.

### **Loans Secured by Financial Assets**

When a borrower uses his or her financial assets—life insurance policies, 401(k) accounts, individual retirement accounts, certificates of deposit, stocks, bonds, etc.—as security for a loan, the borrower has a contingent liability.

The lender is not required to include this contingent liability as part of the borrower's recurring monthly debt obligations provided the lender obtains a copy of the applicable loan instrument that shows the borrower's financial asset as collateral for the loan. If the borrower intends to use the same asset to satisfy financial reserve requirements, the lender must reduce the value of the asset (the account balance, in most cases) by the proceeds from the secured loan and any related fees to determine whether the borrower has sufficient reserves.

### **Open 30-Day Charge Accounts**

Open 30-day charge accounts require the balance to be paid in full every month. Fannie Mae does not require open 30-day charge accounts to be included in the debt-to-income ratio.

See B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018), for additional information on open 30-day charge accounts.

### **Other Real Estate Owned—Qualifying Impact**

For details regarding the qualifying impact of other real estate owned, see B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015).

### **Revolving Charge/Lines of Credit**

Revolving charge accounts and unsecured lines of credit are open-ended and should be treated as long-term debts and must be considered

part of the borrower's recurring monthly debt obligations. These tradelines include credit cards, department store charge cards, and personal lines of credit. Equity lines of credit secured by real estate should be included in the housing expense.

If the credit report does not show a required minimum payment amount and there is no supplemental documentation to support a payment of less than 5%, the lender must use 5% of the outstanding balance as the borrower's recurring monthly debt obligation.

For DU loan casefiles, if a revolving debt is provided on the loan application without a monthly payment amount, DU will use the greater of \$10 or 5% of the outstanding balance as the monthly payment when calculating the total debt-to-income ratio.

### Student Loans

If a monthly student loan payment is provided on the credit report, the lender may use that amount for qualifying purposes. If the credit report does not reflect the correct monthly payment, the lender may 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, the lender must determine the qualifying monthly payment using one of the options below.

- If the borrower is on an income-driven payment plan, the lender may obtain student loan documentation to verify the actual monthly payment is \$0. The lender may then qualify the borrower with a \$0 payment.
- For deferred loans or loans in forbearance, the lender may 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.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2020-07	December 16, 2020
Announcement SEL-2020-01	February 05, 2020
Announcement SEL-2019-09	December 04, 2019
Announcement SEL-2019-08	October 02, 2019
Announcement SEL-2018-09	December 04, 2018
Announcement SEL-2018-01	January 30, 2018
Announcement SEL-2017-09	October 31, 2017
Announcement SEL-2017-06	July 25, 2017
Announcement SEL-2017-04	April 25, 2017
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2016-04	May 31, 2016
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2014-16	December 16, 2014
Announcement SEL-2011-04	May 24, 2011
Announcement SEL-2010-13	September 20, 2010
Announcement -2009-32	October 30, 2009
Announcement -2009-02	February 6, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015)

### B3-6-06, Qualifying Impact of Other Real Estate Owned (06/30/2015)

#### Introduction

This topic describes the qualifying impact of other real estate owned, including:

- Qualifying Considerations
- Mortgage Assumption
- Property Settlement Buyout
- Current Principal Residence Pending Sale

#### Qualifying Considerations

When the borrower owns mortgaged real estate, the status of the property determines how the existing property's PITIA must be considered in qualifying for the new mortgage transaction. If the mortgaged property owned by the borrower is

- an existing investment property or a current principal residence converting to investment use, the borrower must be qualified in accordance with, but not limited to, the policies in topics B3-3.1-08, Rental Income (06/03/2020), B3-4.1-01, Minimum Reserve Requirements (10/07/2020), and, if applicable B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020);
- an existing second home or a current principal residence converting to a second home, the PITIA of the second home must also be counted as part of the borrower's recurring monthly debt obligations; or

- the borrower's current principal residence that is pending sale but will not close (with title transfer to the new owner) prior to the subject transaction, the lender must comply with the policies in this topic.

In conjunction with the policies in this topic, the lender must also comply with the policies in B2-2-03, Multiple Financed Properties for the Same Borrower (12/16/2020), B3-3.1-08, Rental Income (06/03/2020), and B3-4.1-01, Minimum Reserve Requirements (10/07/2020), as applicable.

### Mortgage Assumption

When a borrower sells a mortgaged property and the property purchaser assumes the outstanding mortgage debt without a release of liability, the borrower has a contingent liability.

The lender is not required to count this contingent liability (PITIA) as part of the borrower's recurring monthly debt obligations if the lender verifies that the property purchaser has at least a 12-month history of making regular, timely payments for the mortgage. The lender can document this by obtaining

- evidence of the transfer of ownership;
- a copy of the formal, executed assumption agreement; and
- a credit report indicating that consistent and timely payments were made for the assumed mortgage.

If the lender cannot document timely payments during the most recent 12-month period, the applicable mortgage payment must be counted as part of the borrower's recurring monthly debt obligations.

### Property Settlement Buyout

When a borrower's interest in a property is bought out by another co-owner of the property, as often happens in a divorce settlement, but the lender does not release the borrower from liability under the mortgage, the borrower has a contingent liability.

If the lender obtains documentation to confirm the transfer of title to the property, this liability does not have to be considered as part of the borrower's recurring monthly debt obligations.

### Current Principal Residence Pending Sale

If the borrower's current principal residence is pending sale, but the transaction will not close with title transfer to the new owner prior to the subject transaction, and the borrower is purchasing a new principal residence, the current PITIA and the proposed PITIA must be used in qualifying the borrower for the new mortgage loan.

However, Fannie Mae will not require the current principal residence's PITIA to be used in qualifying the borrower as long as the following documentation is provided:

- the executed sales contract for the current residence, and
- confirmation that any financing contingencies have been cleared.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2015-07	June 30, 2015
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
Announcement -2009-32	October 30, 2009
Announcement -2009-02	February 6, 2009

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018)

### B3-6-07, Debts Paid Off At or Prior to Closing (01/30/2018)

#### Introduction

This topic contains information on debts paid off at or prior to closing, including:

- Payoff or Paydown of Debt for Qualification
- Open 30-Day Charge Accounts
- Collections, Charge-Offs of Non-Mortgage Accounts, Judgments, and Liens

#### Payoff or Paydown of Debt for Qualification

Payoff or paydown of debt solely to qualify must be carefully evaluated and considered in the overall loan analysis. The borrower's history of credit use should be a factor in determining whether the appropriate approach is to include or exclude debt for qualification. Generally

- Installment loans that are being paid off or paid down to 10 or fewer remaining monthly payments do not need to be included in the borrower's long-term debt.
- If a revolving account balance is to be paid off at or prior to closing, a monthly payment on the current outstanding balance does not need to be included in the borrower's long-term debt, i.e., not included in the debt-to-income (DTI) ratio. Such accounts do not need to be closed as a condition of excluding the payment from the DTI ratio.

See B3-6-02, Debt-to-Income Ratios (02/05/2020) for additional guidance on calculating total monthly obligations for qualifying purposes.

#### Open 30-Day Charge Accounts

For open 30-day charge accounts that do not reflect a monthly payment on the credit report, or 30-day accounts that reflect a monthly

payment that is identical to the account balance, lenders must verify borrower funds to cover the account balance. The verified funds must be in addition to any funds required for closing costs and reserves.

**Note:** DU will include the balance of the 30-day charge accounts on the loan application in the Reserves Required to be Verified amount shown on the DU Underwriting Findings report. However, for transactions that do not require the verification of reserves, the balance of 30-day charge accounts in the Reserves Required to be Verified amount will be reduced by any cash out the borrower will receive through the transaction.

If the borrower paid off the account balance prior to closing, the lender may provide proof of payoff in lieu of verifying funds to cover the account balance.

### Collections, Charge-Offs of Non-Mortgage Accounts, Judgments, and Liens

Delinquent credit—including taxes, judgments, charge-offs of non-mortgage accounts (see below for exceptions), tax liens, mechanics’ or materialmen’s liens, and liens that have the potential to affect Fannie Mae’s lien position or diminish the borrower’s equity—must be paid off at or prior to closing.

Delinquent federal income taxes that are approved to be paid by a monthly installment agreement with the IRS must be paid in full at or prior to closing if there is any indication that a Notice of Federal Tax Lien has been recorded against the borrower in the county in which the subject property is located. For additional information about federal income tax installment agreements, see B3-6-05, Monthly Debt Obligations (12/16/2020).

For details regarding delinquent federal income taxes that the IRS has approved to be paid through an installment agreement that can be included as a monthly debt obligation, rather than being paid in full, also see B3-6-05, Monthly Debt Obligations (12/16/2020).

For manually underwritten loans, collection accounts and charge-offs on non-mortgage accounts do not have to be paid off at or prior to closing if the balance of an individual account is less than \$250 or the total balance of all accounts is \$1,000 or less. Collection accounts and charge-offs on non-mortgage accounts that exceed these limits do not have to be paid off at or prior to closing, provided the lender can document a strong credit profile, and meaningful financial reserves.

For DU underwritten loans, refer to B3-5.3-09, DU Credit Report Analysis (12/04/2019).

### Related Announcements

The table below provides references to the Announcements and Release Notes that have been issued that are related to this topic.

Announcements and Release Notes	Issue Date
Announcement SEL-2018-01	January 30, 2018
Announcement SEL-2016-08	October 24, 2016
Announcement SEL-2015-06	May 26, 2015
Announcement SEL-2014-10	July 29, 2014
Announcement SEL-2014-03	April 15, 2014
Announcement SEL-2013-03	April 9, 2013
DU Version 9.0	March 19, 2013
Announcement SEL-2012-13	November 13, 2012
Announcement SEL-2012-07	August 21, 2012
DU Version 9.0	July 24, 2012
Announcement SEL-2010-13	September 20, 2010
DU Version 8.2	September 20, 2010

Agency Guides > Fannie Mae Single Family > 2020 Selling Guide > Part B, Origination Through Closing > Subpart B3, Underwriting Borrowers > Chapter B3-6, Liability Assessment > B3-6-08, DU: Requirements for Liability Assessment (01/27/2015)

### B3-6-08, DU: Requirements for Liability Assessment (01/27/2015)

#### Introduction

This topic contains information on DU requirements for liability assessment, including:

- Reconciling the Loan Application with the Credit Report
- Auto-Populating DU Liabilities from the Credit Report

#### Reconciling the Loan Application with the Credit Report

DU uses liabilities from the loan application, not debts from the credit report, to calculate the debt-to-income ratio.

To help ensure that all appropriate liabilities are included in the debt-to-income ratio, DU performs a series of reasonableness tests comparing loan application balances and payments with the credit report balances and payments. If the values on the loan application are less than the values on the credit report by more than selected tolerances, the lender must justify the discrepancies between the two. The lender must update the loan application values if the values are needed to calculate accurate ratios. The information must be updated either with verified values from the credit report or with independent, outside verifications.

#### Auto-Populating DU Liabilities from the Credit Report

The lender can automatically copy the borrower’s liabilities from the credit report to the loan application by selecting the auto-populate liabilities option from DU when the credit report is ordered. If the lender’s loan origination system does not offer this option, or if the lender elects not to use it, the liabilities must be entered manually into the loan application.

When the auto-populate option is selected, it is not necessary to obtain additional borrower disclosure for tradelines appearing on the credit

report. The lender is still required to obtain full disclosure from all borrowers, including borrowers who do not have traditional credit, of all existing credit obligations. Liabilities that do not appear on the credit report, such as monthly housing expenses for taxes, insurance, must be disclosed in the loan application prior to final submission to DU.

If the auto-populate liabilities option is selected BEFORE liabilities have been manually entered in the loan application:

- Open accounts will be automatically copied to the loan application.
- Closed accounts on the credit report are not automatically copied to the loan application. If the account has an outstanding balance, the lender must manually enter the liability in the loan application and include the monthly payment in the debt-to-income ratio.
- Collection accounts on the credit report are not automatically copied to the loan application.

If the auto-populate liabilities option is selected AFTER liabilities have been manually entered in the loan application:

- DU will attempt to match existing liability accounts listed on the loan application to the credit report liabilities by using a combination of account name and account number.
- Open accounts from the credit report that were not manually entered on the loan application will be automatically copied to the loan application.
- DU will use the information on the loan application to calculate the debt-to-income ratio.

If duplicate accounts or accounts that do not belong to the borrower were copied to the loan application and included in the debt-to-income ratio, they may be omitted (or deleted) from the loan application. Debts that are omitted will not be counted in the debt-to-income ratio.

### Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcement	Issue Date
Announcement SEL-2015-01	January 27, 2015
Announcement SEL-2010-16	December 1, 2010

