



# Bankers Advisory

## COMPLIANCE MONITOR

December 16, 2014

### *Fannie Mae Updates Underwriting Rules for Self-Employed Income*

By Anna DeSimone, President

December 16, 2014, Fannie Mae issued Selling Guide Announcement SEL-2014-16. The *Selling Guide* has been updated to include changes to the following:

- Self-Employed Income
- Servicing Execution Tool
- Solar Panels
- Adjustments to Comparable Sales
- Flood Insurance for Nonresidential Detached Structures
- Cure Provision for Points and Fees
- Payment Calculation for Student Loans
- Nonstandard Repayment Plans
- Incorporation of *Selling Guide* Announcement SEL-2014-14, *Lender Selling Representations and Warranties Framework Update*
- ARM Plan Update
- Miscellaneous *Selling Guide* Updates

The update related to Self-Employed income is described below. Please refer to the Fannie Mae Announcement for important information concerning the other topics listed.

Fannie Mae conducted a comprehensive review of policies related to self-employment income and the *Cash Flow Analysis* (Form 1084). Through this review, Fannie Mae determined that lenders are not consistently applying certain self-employed income policies, and a number of policies were in need of clarification. As a result, the *Selling Guide* has been updated to provide additional clarity, with a goal of increased consistency in the application of those policies. Notable changes include (but are not limited to):

- **Analysis of Borrower's Personal Income** – Clarified that a lender is not required to prepare a written evaluation of self-employment income when the borrower is qualified using only salaried income and self-employment is a separate and secondary source of income (or loss).
- **Analysis of Borrower's Business Income** – Clarified that a lender is required to perform an analysis of a borrower's business income when a borrower is relying on it to qualify and the requirements that permit the lender to waive business tax returns are not met.
- **Business income reported for a borrower on Schedule K-1 (IRS Forms 1065 or 1120S)**

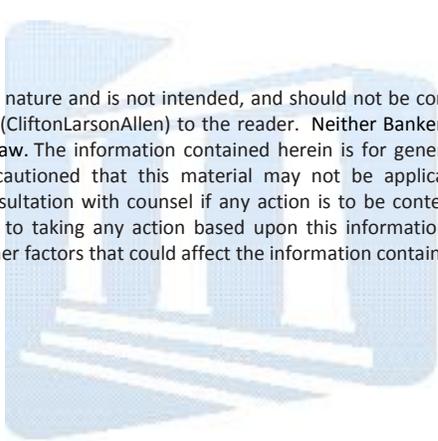
- Clarified that Schedule K-1 for the most recent two years is required when using business income to qualify.
- Clarified that business income may be used in qualifying the borrower only when there is a history of income distribution to the borrower consistent with the level being used to qualify.
- Expanded the reference to ordinary income to include net rental real estate income and other net rental income reported on Schedule K-1.
- **Income Verification for Self-Employed Co-Borrowers** – Provided additional guidance regarding the documentation required.
- **Use of Business Assets** – Provided guidance regarding the documentation that may be necessary to confirm that the withdrawal of funds will not have a negative impact on the business.
- **Fannie Mae Cash Flow Analysis (Form 1084)** – Revised to reflect policy clarifications and align with IRS tax forms and terminology.

#### ***Updated Selling Guide Topics***

- B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower
- B3-3.2-02, Business Structures
- B3-3.2.1-08, Income or Loss Reported on IRS Form 1065 or 1120S, Schedule K-1
- B3-3.2.2-01, Analyzing Partnership Returns for a Partnership or LLC
- B3-3.2.2-02, Analyzing Returns for an S Corporation

#### ***Effective Date***

Lenders may implement these changes immediately but must do so for applications dated on or after April 1, 2015.



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