



Guide Bulletin 2016-19

Revised Income Requirements

Customer Education

October 2016



NOTE: This document is not a replacement or substitute for the information found in the *Single-Family Seller/Service Guide*, and/or terms of your Master Agreement and/or Master Commitment.

Comprehensive revisions were made to our income qualification requirements with a focus on matters that impact analysis of stable monthly income including:

- Industry employment trends (e.g. employment characteristics)
- Determination of stability and calculation of fluctuating earnings
- Self-employment

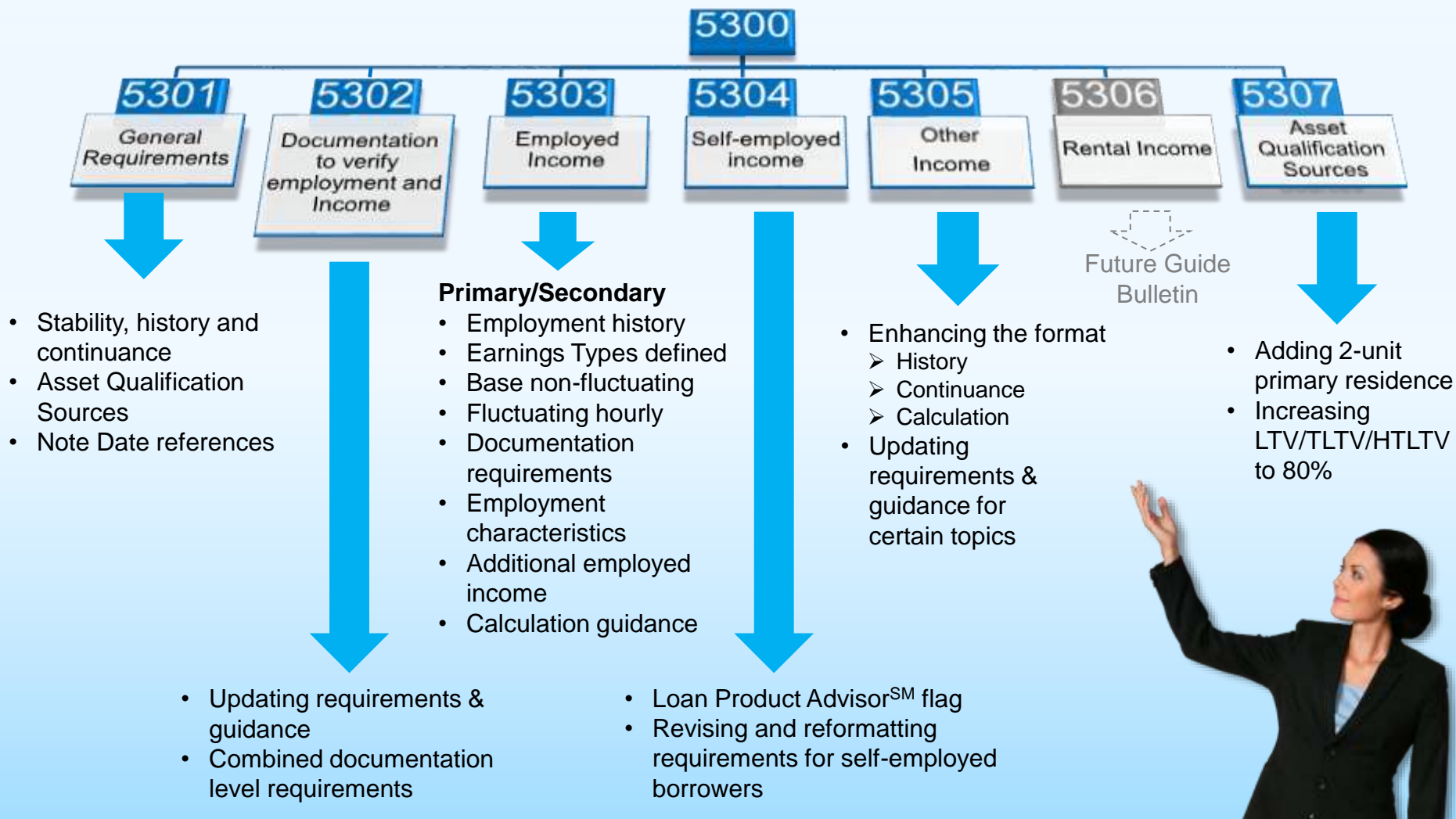


Agenda: Summary* of Changes

Effective for mortgages with Freddie Mac settlement dates on or after 3/6/2017



Stable Monthly Income and Asset Qualification Sources



*In addition to Guide Bulletin 2016-19, we encourage you to review the future version of the Guide chapters under Topic 5300 in their entirety as several sections have also been reformatted and reorganized to improve readability.

Fixed


Income types with pre-determined fixed payment amounts that occur with regular frequency and/or have defined and documentable terms lend support to income stability

- The analysis of historical receipt is typically not necessary

Fluctuating

Income types that fluctuate typically must be viewed from the perspective of historical earnings

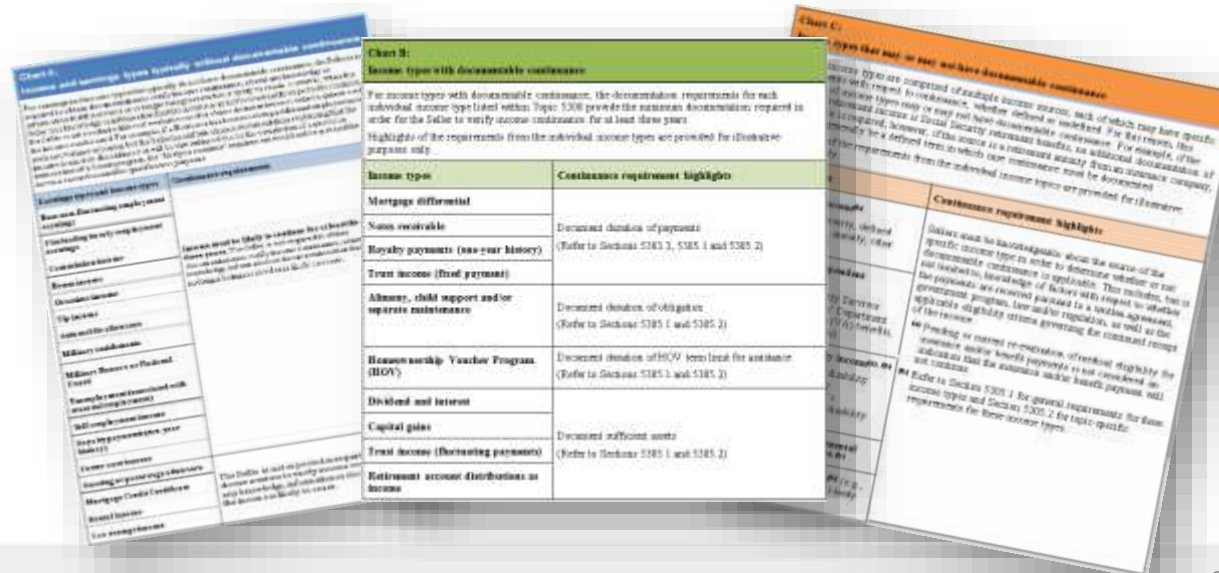
- Consider the length of history, degree of fluctuation and/or irregularity of the income
- Additional layering of risk may be present depending upon the degree of income volatility
- Additional documentation (e.g., an additional year of earnings history) is necessary to support income stability



Note: In most instances, a two-year history of receiving income is required in order for the income to be considered stable and used for qualifying. When the Borrower has less than a two-year history of receiving income, the Seller must provide a written analysis to justify the determination that the income that is used to qualify the Borrower is stable. While the sources of income may vary, the Borrower should have a consistent level of income despite changes in the sources of income.

Income continuance charts were added that provide excerpts of existing income continuance requirements categorized as follows:

- Income and earnings types typically without documentable continuance (likely to continue)
- Income types with documentable continuance
- Income types that may or may not have documentable continuance, depending upon the source (e.g., government program, private insurer) of the specific income type (e.g., retirement, long-term disability)



Updated and Added Guidance

- Streamlined and standard documentation levels will be equivalent for **all** income types
- Year-to-date paystubs
- W-2 Forms
- Written VOE
- Ten-Day Pre-Closing Verification (PCV)
- Third-party verification service providers



- IRS Transcripts
- When tax returns are required (chart format)
- Signed tax returns (acceptable alternatives)
- Unreimbursed business expenses
- 4506-T requirements

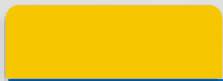
Employed Income & Documentation Requirements



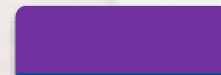
• **Employment History**



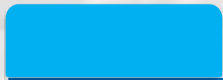
• **Documentation**



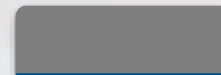
• **Earnings Types Requirements**



• **Additional Employed Income**

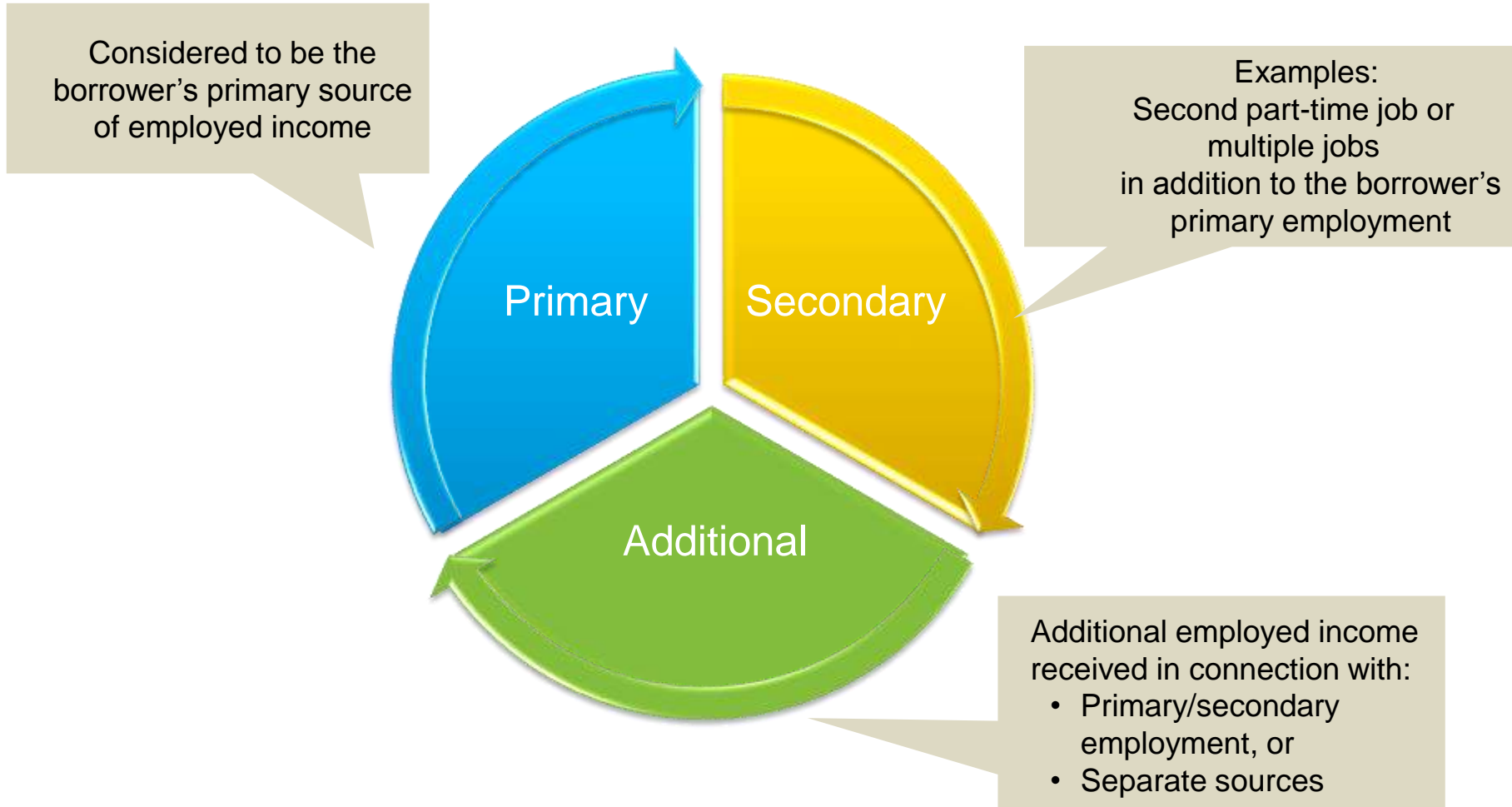


• **Employment Characteristics**



• **Income Calculations**

Employed Income: Three primary components



Employment History Requirements – Primary and Secondary Employment

- **Employment history-** Added specificity by placing and emphasized requirements in each applicable section
- **Employment history less than two years-** added guidance, as follows:
 - » **Primary employment:** Updated existing requirements into guidance (newly employed, employment gap explanations, returning to workforce) for primary employment
 - » **Secondary employment or multiple jobs:** Added examples of instances where an employment history of less than two years may be acceptable



Rhonda is employed in the educational system as a teacher. During the previous summer, she taught summer school within the same educational system. She is now beginning to teach summer school for the current year.

Although the two-year history is not yet fully developed, would you accept this loan given the job type and current employment situation?



Employed Income – Earnings Types: Primary & Secondary



For employed primary and secondary earnings, we added requirements delineating base non-fluctuating and fluctuating hourly earnings to support analysis of income stability and accurate income calculation.



Base Non-Fluctuating

For the purposes of determining stable monthly income, base non-fluctuating employment earnings are considered to be earnings with a pre-determined and agreed upon rate of pay and number of hours worked each pay period. Base non-fluctuating earnings may include both exempt (salaried) and non-exempt earnings; however, the pay rate and number of hours worked must not fluctuate between pay periods.



Fluctuating Hourly

For the purposes of determining stable monthly income, fluctuating hourly employment earnings are considered to be employment earnings with hours that may fluctuate each week or pay period. The hours are not pre-determined; however, the employer and the borrower may have a general expectation of weekly hours. The hourly pay rate is a pre-determined and agreed upon fixed amount.

>>Do not represent additional employed income <<

Employed Income – Employment Characteristics: Primary & Secondary

Full-time & Part-time

Union Members

Employment Contracts

Temporary Help Services

1099 Income for services performed

Employed Income from Foreign Source

Seasonal

Employed by Family or Interested Party



For borrowers in the educational field, would you accept a renewable or term contract?

If a borrower in the educational field provides you with an annually renewable contract or term contract, it is safe to assume a reasonable expectation of continuance or probability of consistent receipt, provided that you do not have knowledge, information or documentation to the contrary.

Employed Income – Income Commencing After the Note Date: Requirements & Eligibility



- Employment and Earnings Type:
 - » Primary employment
 - » Base non-fluctuating salaried earnings

- General Eligibility:
 - » Purchase transaction
 - » 1-unit primary residence
 - » Borrowers employed by a family member or interested party to the transaction are ***ineligible***



Employed Income - Income Commencing After the Note Date: Additional Requirements

Prior to the Note Date, you must determine and document in your written analysis one of the two following options:



Option 1

- A paystub for the new employment is not required
- The Note Date cannot occur more than 60 days prior to the commencement of employment as documented on the offer letter or employment contract, and
- Document adequate income and/or liquid assets to pay the monthly housing expense and or monthly liabilities between the Note Date and the employment start date, and
- Document an additional six months reserves

Option 2

- Obtain the paystub for the new employment prior to the Delivery Date and retain it in the Mortgage file
- The paystub must validate the income used to qualify, and
- Document adequate income and/or liquid assets to pay the monthly housing expense and other monthly liabilities between the Note Date and the employment start date

Restructured documentation requirements by earnings types

- Primary employment earnings
 - » Reducing the W-2 requirements from 2 years to 1 year
- Secondary employment earnings



Revised YTD paystub references, as follows:

- **From:** YTD paystub ~~or salary voucher~~ documenting ~~at least 30 days of income~~
- **To:** YTD paystub(s) **documenting all YTD earnings**



Military Base (Basic) Pay:

- Relocating from additional employed income types to employed income
- Reducing the W-2 requirements from 2 years to 1 year

10-day Pre-Closing Verification (PCV)

Types:

- Verbal VOE
- Written VOE
- Military LES
- Third party employment verification service provider-electronically generated-
Updated: must evidence that the information in the database is no more than 35 days old



What Changed?



Form 90 – Update

- Removed the requirement that the Form 90 include the:
 - » Borrower's position, and
 - » Length of employment

Additional employed income updates include:

- Commission income less than 25% of the income from the commissioned employment
- Commission income greater than or equal to 25% of the income from the commissioned employment
- Tip income – Cash and charge tips reported on Internal Revenue Service (IRS) Form 4137
- Mortgage differential
- Military entitlements
- Military Reserves and National Guard
- Unemployment compensation associated with seasonal employment

Additional Income: Commission



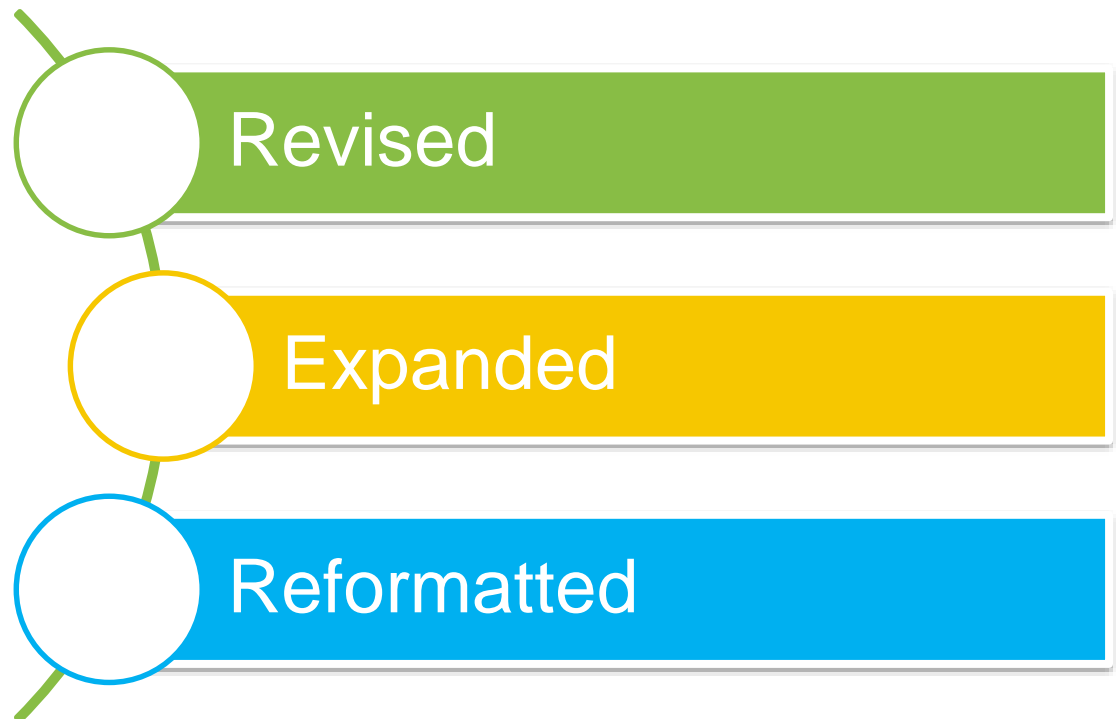
| Type | Documentation (Streamlined & Standard) |
|--|---|
| Commission income is < 25% of the income from commissioned employment | <p>All of the following:</p> <ul style="list-style-type: none"> ▪ Year-to-date (YTD) paystub(s) documenting all YTD earnings, W-2 forms for the most recent two calendar years and a 10-day PCV OR, <i>all of the following:</i> ▪ Written verification of employment (VOE) documenting all YTD earnings, the earnings for the most recent two calendar years and a 10-day PCV |
| Commission income is ≥ 25% of the income from the commissioned employment | <p>All of the following:</p> <ul style="list-style-type: none"> ▪ YTD paystub(s) documenting all YTD earnings, W-2 forms for the most recent two calendar years, and a 10-day PCV ▪ Complete federal individual income tax returns covering the most recent two-year period, OR <i>all of the following:</i> <ul style="list-style-type: none"> ▪ Written VOE documenting all YTD earnings and the earnings for the most-recent two calendar years, and a 10-day PCV ▪ Complete federal individual income tax returns covering the most-recent two-year period |

History of receipt: Two consecutive years

Continuance: Must be likely to continue for at least the next three years

Calculation: Refer to Section 5303.4(b) for calculation requirements. When the commission income is greater than 25% of the commissioned employment, unreimbursed employee expenses must be deducted from the borrower's gross commission income

Self-Employed Income & Documentation Requirements



Self Employed: Definition

A Borrower who has an ownership interest of 25% or more in a business is considered to be self-employed. The business may be a sole proprietorship, a Partnership (general or limited), an S corporation or a corporation

| Business Structure | Self-employment Verification of ownership interest percentage |
|---|--|
| Partnerships, S Corporations and Corporations | The ownership interest percentage must be verified by a review of the federal income tax returns for the business, including the IRS Schedule K-1(s) or IRS Form 1125-E, Compensation of Officers. If these documents do not provide this information, the ownership interest percentage must be verified with a letter from the accountant for the business or similar documents. |
| Sole Proprietorships | Sole proprietorships are unincorporated businesses. A sole proprietor owns 100% of the business and reports the income and expenses from that business on Schedule C of the federal individual income tax return. There is no associated federal business tax return. |

Effective for mortgages with settlement dates on or after 3/6/2017

A Seller must indicate to Loan Product Advisor that a borrower is self-employed **when the income or loss is used for qualification**

Previous requirement:

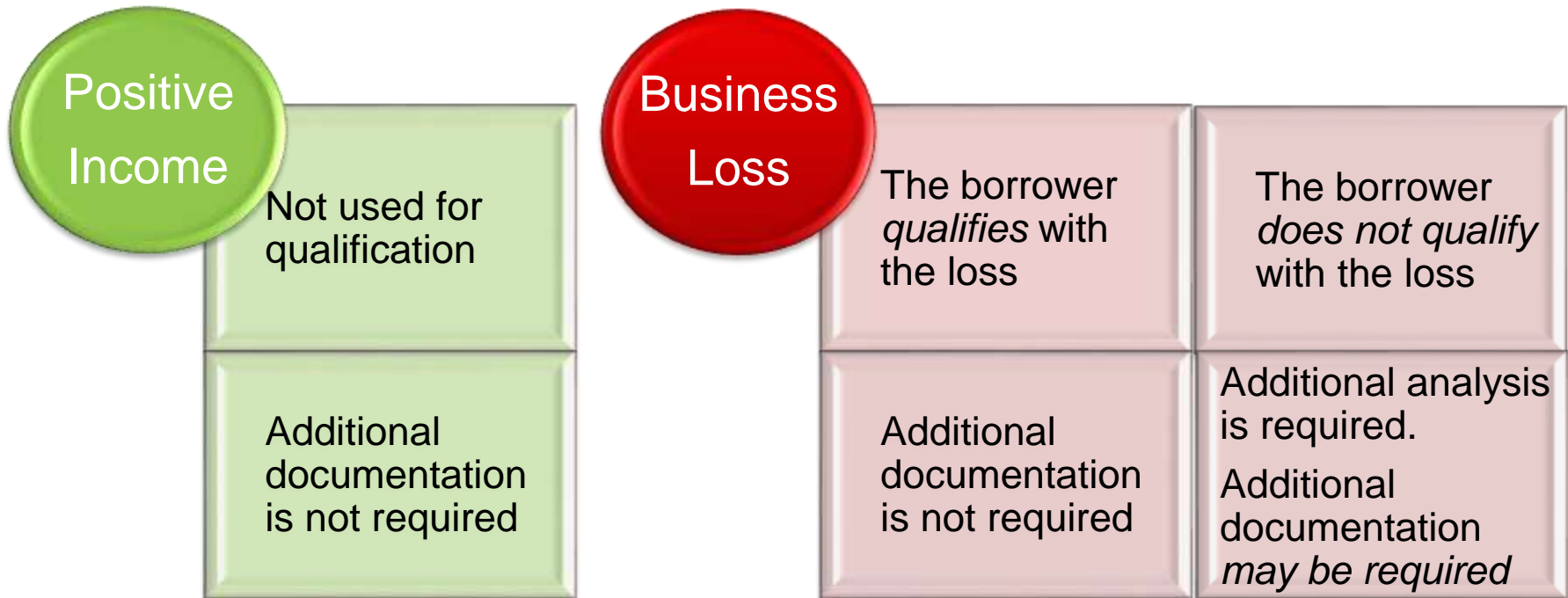
Required in all cases *whether or not* the Seller is using the self-employment income to qualify the borrower



Self-employment disclosed but NOT Considered for Qualification...




Obtain pages 1 and 2 of the borrower's federal individual income tax returns, including applicable schedules



Self-Employed: Business and Income Analysis

Your analysis of the business **must** support that the business has sufficient liquidity and is financially capable of producing stable monthly income for the borrower

- Analyze the applicable business tax returns

- 
- » At a minimum, analyze gross receipts or sales, cost of goods sold and gross profits
 - » All should be typical for the type of business and reflect consistent year over year trends
 - » The business expenses should be reasonable for the type of business activity and level of business income
 - » Business tenure should be considered

- You may determine that review and analysis of the business financial statements and/or business asset statements is necessary to establish the financial and liquidity standing of the business

- Financial statements for the business may be used to assist in evaluating and determining various components of self-employment analysis, including, but not limited to:
 - business liquidity
 - income stability when tax returns are on extension
 - evaluating a newer business, and
 - the impact of business fund withdrawals



When analyzing the terms of mortgages and notes payable in less than one year, perform an income analysis

Some questions you may ask yourself are:

- Does the business have sufficient liquidity to pay off the debt without a negative impact to the business?
- Is the business type one where inventory will continually roll over?
- Is the debt a line of credit that is consistently renewable?

*If the answer is **yes** and the above factor(s) are present, the income **does not** need to be reduced by the debt when performing your analysis.*



new



Tax Return Documentation Requirements for all Business Structures



Business operating *five or more* years

- **One** year business returns and
- **One** year personal returns required

Business operating *less than five* years

- **Two** years business and
- **Two** years personal returns required

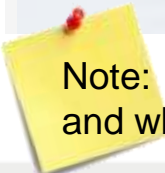
Verification of how long the business has been in existence:

- For partnerships, S corporations and corporations, the federal income tax return(s) for the business must indicate the number of years that the business has been in existence
- For sole proprietorships, the federal individual income tax return(s) and any other documentation or information received must not contradict the number of years that the business has been in existence as documented on Form 65, Uniform Residential Loan Application

Documentation is not required to verify access to business income for the following:

- **Sole proprietorships**
- **Ordinary income, net rental real estate income, other net rental income and guaranteed payments received from partnerships and S corporations**
- **W-2 income received from S corporations and corporations**
- **Corporations, if the Borrower holds 100% ownership interest**

If the business income is not reported on the borrower's personal income tax returns and is being used to qualify, additional documentation is required to support the borrower's access to the business income



Note: Please refer to Guide Section 5304.1(d) for instances when **use of business income is reported** and when it is **not reported** on the Borrower's personal income tax returns.

updated

- *Extended from 30 days to 120 days* prior to the note date
- *Alternative sources* may be used when other third party options are not available, such as:
 - » The preparer of the tax returns for the business (e.g., accountant), provided the preparer has an arm's length relationship with the Borrower
 - » Most recent one month business bank statement that supports the current existence of the business and the level and type of income and expenses reported on the business tax returns





Review and analyze the current financial statements...

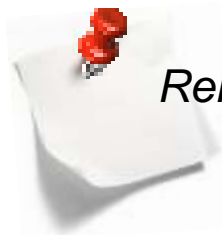


Expanded guidance

and/or



...the last three months of the business bank statements



Reminder: The factors contributing to the determination that the withdrawal will not negatively impact the business must be included in your written analysis of the income source and amount

All rental real estate income and expenses reported on *IRS Form 8825* for partnerships and S corporations are to be *treated as self-employment* income, regardless of whether or not the Borrower is personally obligated on the note



Other Income

History

Continuance

Calculation



Other Income: Reformatted & Updated

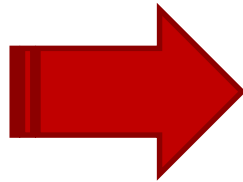
Example:

Current

| Income type | Stable monthly income requirements | Documentation requirements |
|-----------------------|--|--|
| | | Streamlined Accept and Standard Documentation Levels |
| Notes receivable | Income from Notes Receivable may be considered qualifying income if the Mortgage file contains a copy of the note and evidence that the Borrower has received payments on a regular monthly basis for the most recent 12 months. Notes Receivable income must continue for at least the next three years. | Copy of the note evidencing the terms including, but not limited to, the scheduled amount and duration of payments, and proof of receipt of payments for the most recent one-year period. |
| Dividend and interest | Dividend and interest income may be considered qualifying income if the Mortgage file contains evidence that the income has been received for the most recent two years. Sufficient assets remaining after closing must be documented to support continuance of the dividend and interest income, at the level used for qualifying, for at least the next three years. | Copy of the most recent two years of federal tax returns (including Capital Gains and Losses, Schedule D), showing that the Borrower has received payments on a regular monthly basis for the most recent 12 months. |
| Capital gains | Capital gains may be considered qualifying income if the Borrower's most recent two years' individual federal tax returns (including Capital Gains and Losses, Schedule D), show that the Borrower has received payments on a regular monthly basis for the most recent 12 months. | Copy of the most recent two years of federal tax returns (including Capital Gains and Losses, Schedule D), showing that the Borrower has received payments on a regular monthly basis for the most recent 12 months. |

Update

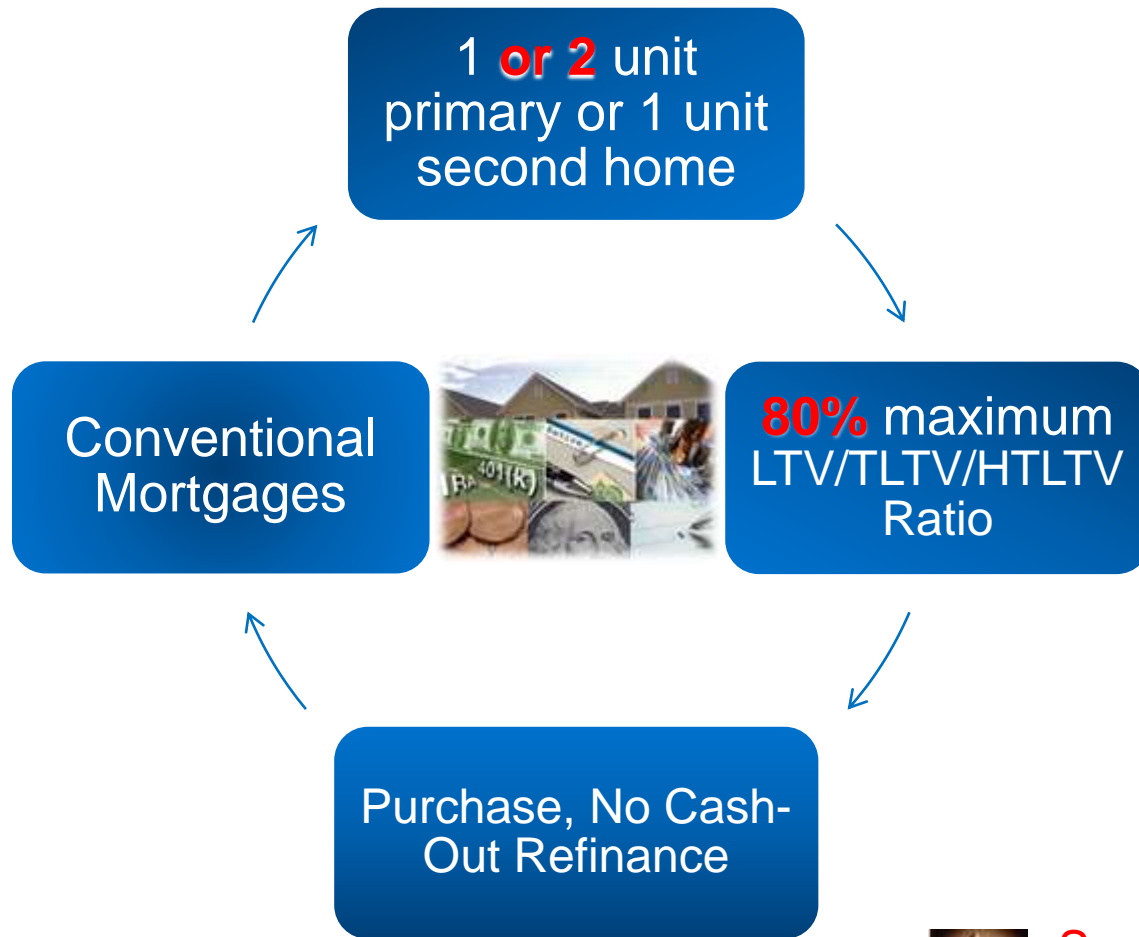
| Income type | Stable monthly income requirements | Documentation requirements |
|-----------------------|---|--|
| | | Streamlined Accept and Standard Documentation Levels |
| Notes receivable | <p>History of receipt: Receipt of payments on a regular monthly basis for the most recent 12 months.</p> <p>Continuance: Note receivable income must continue for at least three years.</p> | Copy of the note evidencing the terms including, but not limited to, the scheduled amount and duration of payments, and proof of receipt of payments for the most recent 12 months. |
| Dividend and interest | <p>Calculation: Use the amount documented on the federal tax returns for the most recent two years.</p> <p>Calculation: 24-month average</p> | <p>Copy of either:</p> <ul style="list-style-type: none"> Complete federal individual income tax returns for the most recent two-year period <p>or</p> <ul style="list-style-type: none"> Year-end asset account statements for the most recent two years evidencing all dividend and interest income for each year for the income producing asset(s). <p>and</p> <ul style="list-style-type: none"> Evidence of sufficient assets to support the qualifying income |
| Capital gains | <p>History of receipt: Most recent two-years of realized capital gains</p> <p>Continuance: Document that sufficient assets remain after closing to support continuance of the</p> | <ul style="list-style-type: none"> Copy of complete federal individual income tax returns for the most recent two-year period reflecting capital gain income, and, |



Other Income: What changed?

Excerpt from The Guide Bulletin 2016-19, Attachment A

| | | |
|---------------|---|--|
| 5305.2 | Notes receivable | Specifying that the full scheduled payment amount documented on the Note may be used for qualification purposes |
| | Dividends and interest | Adding a documentation alternative of year-end bank statements for the most recent two years in lieu of tax returns |
| | Royalty payments | Revising requirements to be based on the length of history of receipt |
| | Trust income | Revising requirements to be based on whether the trust income payments are fluctuating historical payments or pre-determined fixed payments |
| | Retirement income | Adding a reference to specific requirements for retirement account distributions as income. |
| | Alimony, child support and/or separate maintenance | Specifying that a legally binding separation agreement and/or final divorce decree is acceptable documentation |
| | Other income – foreign sources | <ul style="list-style-type: none"> • Adding specific requirements for other non-employment and non-self-employment income received from foreign sources. The requirements for the specific income type continue to apply. • Complete U.S. federal individual income tax return for the most recent year must be provided |
| | Tax-exempt income | <p>Revising text as follows:</p> <p>To determine the amount to adjust (i.e., "gross-up") the Borrower's income, use:</p> <ul style="list-style-type: none"> • 25% of the tax exempt portion of the income or • The current federal and state income tax withholding tables |



See Section 5307.1 for further details

Loan Product
Advisor

Will be ready by February 6, 2017,
to support these changes

Implementation
Timeline

Effective for mortgages with Freddie Mac
settlement dates on or after March 6, 2017

Review the future
revisions of the
Guide chapters
(under Topic 5300)
in their entirety

Several sections have
also been reformatted
and reorganized to
improve readability

- The Guide Bulletin 2016-29, Attachment A
- Revisions to Income and Asset Qualification Requirements
- Updated Loan Product Advisor Documentation Matrix- **Coming Soon**



The image displays two overlapping screenshots of the Freddie Mac website's 'The Learning Center' page. The left screenshot shows the 'Special Resources' section, where the 'Income and Assets' link is highlighted with a red box. The right screenshot shows the 'Income and Assets' section, which includes a list of resources such as 'Easy to Print References' and 'Online Self-study'. The 'Income and Assets' link in the right screenshot is also highlighted in yellow.

The **Learning Center Updates** page provides quick access to new and updated training resources to help you with underwriting, mortgage products, selling, servicing, and more: FreddieMac.com/learn/ch_ind/

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Elements marked * are required.

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- Workout Prospector®
- Imminent Default Indicator®
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Community Lenders

- Community Lender News

* E-mail Address

* First Name

* Last Name

* Company

(and/or 7-Digit Third-Party Originator Number)

6-Digit Freddie Mac Seller/Service ID

FreddieMac.com/singlefamily/news/subscribe.html

*Get the latest e-mails on single-family news, updates, alerts, and new training and education opportunities on the categories that match what's **most important** for your job, your organization, and your business.*

Certificate of Training Completion



Guide Bulletin 2016-19: Revised Income Requirements

Name

Date

***Please complete the online
evaluation before exiting
today's session***

Thank you for your participation!

