Several Significant Income-Related Underwriting Changes from Fannie

By: Jann Swanson | Wed, Jul 1 2015, 4:07 PM

Highlights from the most recent update to Fannie's Selling Guide:

Conversion of Principal Residence Requirements

At the height of the financial crisis Fannie Mae required lenders to make a manual application to convert a principal residence to a secondary or vacation property in order to ensure that borrowers had adequate capacity and financial reserves to manage multiple properties. Effective immediately Fannie Mae is eliminating requirements specifically associated with such a conversions because of other policies now in place that adequately address credit history, rental income and financial reserves and lenders may use these in the future.

Stocks, Bonds, and Mutual Funds

When a borrower is using vested stocks, bonds, and mutual funds (including retirement accounts) for down payment, closing costs, and reserves 100 percent of the value of the asset will be allowed in determining available reserves. If the lender documents that the asset represents at least 20 percent more than what is needed for the downpayment and closing costs no documentation of liquidation is required. If that determination is not made then the borrower's actual receipt of funds from the sale or liquidation must be obtained. Non-vested assets may not be used.

Unreimbursed Employee Business Expenses

For a borrower who is qualified using base pay, bonus, overtime, or commission income that is less than 25 percent of his or her annual employment, income unreimbursed employee business expenses and union dues and other voluntary deductions will no longer be required to be analyzed or deducted from qualified income or added to monthly liabilities whether or not these expenses are identified on tax returns or tax transcripts. Where more than 25 percent of annual employment income is from commissions, unreimbursed employee business expenses must be deducted from gross commission income regardless of the length of time that the borrower has filed that expense with the IRS. The exception is an actual automobile lease or loan payment. If borrowers report an automobile allowance as part of their monthly qualifying income, the lender must determine if the automobile expenses reported on IRS Form 2106 should be deducted from income or treated as a liability.

Tip Income

In some cases where the full amount of tip income is not reported by the employer on the Form 1005, paystub and W-2 form the borrower may report additional tip income to the IRS using Form 4137, Social Security and Medicare Tax on Unreported Tip Income, when filing his or her tax returns. Fannie Mae will allow this tip income to be used in qualifying if the lender obtains the most recent two years of federal income tax returns with Form 4137.

Use of IRS W-2 Transcripts in Lieu of W-2s

When lenders verify employment income for borrowers whose income is used to qualify for the mortgage loan, borrower-provided paystubs and IRS W-2 forms are one option that can be utilized to document the income. In lieu of W-2 forms, other documentation options are a *Request for Verification of Employment* (Form 1005 or Form 1005 (S)) or the final year-to-date paystub. Fannie Mae will also now permit an IRS "Wage and Income Transcript" (W-2 transcript) in lieu of the actual W-2 forms.

New Closing Disclosure and Loan Estimate Forms

Given both the pending implementation and enforcement of the new the Consumer Financial Protection Bureau (CFPB) Closing Disclosure and Loan Estimate forms as well as the temporary delay in their implementation and enforcement, a number of related changed have been made to the Selling Guide. First is an update to acknowledge that lenders will continue to deliver loans with both old and new forms for a period of time.

Lenders are required to maintain copies of the loan estimate and final settlement statement and any re-disclosures in the mortgage loan file. Fannie Mae will not require that the borrower and seller (if applicable) sign the Closing Disclosure or Loan Estimate but obtaining those signature is still supported as a best practice, especially for the Closing Disclosure.

If there are separate Closing Disclosures for the borrower and seller, the lender must retain copies of each in the mortgage loan file and must use the Closing Disclosure that is applicable to the transaction; i.e. not using the purchase version of the form for a refinance transaction. There is no longer a requirements for a separate escrow waiver disclosure. Other references to items on the settlement statement have been removed and terminology has been changed throughout to reflect changes in the new forms.

Permit Prepayment Penalties on Subordinate Liens

Currently Fannie Mae requires that, when it purchases or securitizes a first mortgage subject to subordinate financing the subordinate financing not include prepayment penalties or restrictions in order to guard against predatory lending and/or severe prepayment penalty scenarios. Regulatory changes have increased borrower protections in this regard and as a result Fannie Mae is removing this restriction.

Seller/Servicer Net Worth and Liquidity Requirements

On May 20, 2015 Fannie Mae updated net worth and minimum liquidity requirements for its seller/servicers. To reflect these changes the following updates have been made to the Selling Guide.

All approved sellers/servicers must have and maintain a Lender Adjusted Net Worth of at least $2.5 million, plus a dollar amount that represents 0.25% of the unpaid principal balance of the seller/servicer's total portfolio of mortgage loans serviced. Those that are depository institutions are required to meet the minimum regulatory capital requirements to be classified as "well capitalized" by their primary regulator.

All other entities must have a minimum Lender Adjusted Net Worth/Total Assets ratio of 6%, or equivalent, as determined by Fannie Mae. Approved non-depository sellers/servicers must have and maintain a minimum liquidity requirement based on the Agency Serious Delinquency Rate, which is defined in the Guides.

Optional Data Fields on Verification of Employment (Form 1005 and 1005 (S))

The Sellers Guide now specifically lists which data fields on the above referenced forms are optional and need not be completed.

Loan-level Defect Reporting of Nonpublic Personal Information to Lenders

To make its loan review findings more useful to lenders, Fannie Mae intends to expand some of the reporting detail made available on specific loans. As this data may include limited borrower nonpublic personal information ("NPI"), Fannie Mae is updating the *Selling Guide* to address potential compliance obligations that might arise under the Gramm-Leach-Bliley Act.

Tracking of Fannie Mae Loan Numbers

Lenders are currently required to provide the Fannie Mae loan number for every mortgage loan to their servicers but not required to provide them to document custodians. The new requirement is that lenders ensure that the document custodian receives, within 30 days of loan certification, the Fannie Mae loan number for every mortgage loan for which the custodian is responsible and respond, within three business days, to any request from the custodian for the Fannie Mae loan number. Document custodians are required to have a process in place to obtain and retain the number for every loan and to be able to perform reconciliations using that loan number. Lenders are encouraged to implement these requirements immediately; however they will be required for all mortgage loans certified by Fannie Mae on and after October 1, 2015.

RD Section 502 Leveraged (Blended) Programs Allowed as Community Seconds

To further expand access to rural housing, Fannie Mae will now purchase conventional first mortgage loans under the Rural Development (RD) 502 Leveraged (Blended) Loan Program that are combined with a direct, low interest rate subordinate Section 502 lien from RD. The subordinate lien will be considered eligible under the Community Seconds program. The standard review of Community Seconds programs is not required but any subordinate lien must meet all RD guidelines. As with any Community Seconds mortgage, Fannie Mae does not purchase the subordinate lien.

The Seller Letter also makes various other changes to the Selling Guide including a notification of a pending change that will treat non-investment trusts as consumer credit, and revisions to two uniform instruments, the Texas Home Equity Affidavit and Agreement and Instructions for the Arizona Deed of Trust.

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