

Let's QC Quarterly Call Series – Community Lending

QC Roadmap – Defects, Pitfalls and Guidance

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Speakers: Rick Holcombe, Matt Puglise and Mary Simon

February 23, 2021



Welcome!

2021 Q1 Let's QC Quarterly Call
– Community Lending Series

Goal of Call Series

01 Provide training and guidance

02 Allow transparency and insight into our Quality Control loan review process

03 Provide useful information to incorporate into your Underwriting and QC process

QC Roadmap – Defects, Pitfalls and Guidance



Topic 1:
Defect Trending



Topic 2:
**Self-Employed
Borrowers in a
C-Corporation**



Topic 3:
**Self-Employed
working for a
Family Member
Owned Business**



Topic 4:
**Underwriting
Self-Employed
Borrowers During
COVID-19**

Topic 1 – Defect Trending

- Defects from 2020 Q4 completed reviews
- Performing Loan Samples only
- Focus on defects appearing in > 5 loans
- Mostly Q1-Q2 2020 funding

Top 10 Defects Overall

Out of 2,072 loans decisioned in Q4 2020 we found 479 defects across 366 unique loans.

Category	Defect	# of Loans
1. Legal / Insurance	Tax/Ins missing or insufficient	95
2. Liabilities	Liability doc missing or insufficient	54
3. Collateral	Appraisal flexibility violation	44
4. Income	Income docs missing	42
5. Income	Income calculated incorrectly	30

Top 10 Defects Overall (continued)

Out of 2,072 loans decisioned in Q4 2020 we found 479 defects across 366 unique loans.

Category	Defect	# of Loans
6. Assets	Insufficient funds to close	25
7. Income	COVID-19 temporary income violation	13
8. Liabilities	Docs to exclude debts missing or insufficient	13
9. Credit	BK docs missing or insufficient	10
10. Liabilities	Payment calculated incorrectly	10

Top 10 Defects Overall (continued)

Key Takeaways

01

Income and Liabilities as a whole still lead the industry in defects

03

Our top Fraud related defects are low and Fraud has been declining; however, Freddie Mac remains vigilant in this space

02

BK and Credit Event defects are on the decline

04

Other collateral defects are low, Loan Collateral Advisor and ACE are helping

Top Defects Related to Transaction

Defect	Primary Area(s)
Purchases, Owner Occupied & Loan Product Advisor	Tax/Insurance missing or insufficient
	Insufficient funds to close
	Liability payment calculated incorrectly (NCO & Cash-Out evenly split with purchases)
	BK docs missing or insufficient (NCO & Cash-Out evenly split with purchases)
No-Cash Out, Owner Occupied & Loan Product Advisor	Liability docs missing or insufficient
	Income docs missing (Cash-Out and Purchase had similar levels)
Cash-Out, Owner Occupied, Loan Product Advisor	Appraisal Flexibility Violation
	Income calculated incorrectly (High level if manual UW as well)
	COVID-19 temporary income violation
	Docs to exclude liabilities missing or insufficient (NCO and Purchase had similar levels)

Top Defects Related to Transaction (continued)

Key Takeaways

01

The Freddie Edge is evident in the use of tools from the Freddie Mac Loan Advisor toolbox

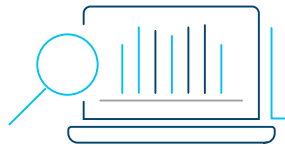
02

Currently, we are seeing a high level of Owner-Occupied transactions, both in your segment and the industry

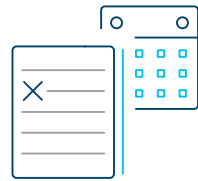
03

COVID-19 Temporary Guidelines issues were concentrated in Cash-Out refinances

Defects for Second Homes and Investment Properties



**Income
miscalculated**



**Taxes and Insurance
documents missing
or insufficient**



**Liability documents
missing or insufficient**



Questions?

Topic 2 – Self-Employed Borrowers in a C-Corporation

Definition of a Self-Employed Borrower

5304.1 Stable monthly income and documentation requirements for self-employed Borrowers

(a) Self-employed Borrower definition and verification of ownership interest percentage

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.

Topic 2 – Self-Employed Borrowers in a C-Corporation

Excerpts of Borrower's Application

Borrower				III. BORROWER INFORMATION				Co-Borrower			
Borrower's Name (include Jr. or Sr. if applicable) John Doe				Co-Borrower's Name (include Jr. or Sr. if applicable) Jane Doe							
Social Security Number	Home Phone (incl. Area code)	DOB (mm/dd/yyyy)	Yrs. School	Social Security Number	Home Phone (incl. Area code)	DOB (mm/dd/yyyy)	Yrs. School				
111-22-3333	(478)854-1##3	01/01/1970	16	444-55-6666	same	02/02/1970	18				
<input checked="" type="checkbox"/> Married <input type="checkbox"/> Separated <input type="checkbox"/> Unmarried (include single, divorced, widowed)		Dependents (not listed by Co-Borrower) no. 1 ages 12		<input checked="" type="checkbox"/> Married <input type="checkbox"/> Separated <input type="checkbox"/> Unmarried (include single, divorced, widowed)		Dependents (not listed by Borrower) no. ages					
Present Address (street, city, state, ZIP) XXXXXXXXXXXXXXXXXX		<input checked="" type="checkbox"/> Own <input type="checkbox"/> Rent 15 No. Yrs.		Present Address (street, city, state, ZIP) XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX		<input checked="" type="checkbox"/> Own <input type="checkbox"/> Rent 15 No. Yrs.					
Mailing Address, if different from Present Address				Mailing Address, if different from Present Address							

Borrower		IV. EMPLOYMENT INFORMATION		Co-Borrower	
Name & Address of Employer Great Widget Corporation 123 Anystreet Anytown, ST, 00000	<input type="checkbox"/> Self Employed	Yrs. on this job 4	Yrs. employed in this line of work/profession 20	Name & Address of Employer	<input type="checkbox"/> Self Employed
Position/Title/Type of Business General manager	Business Phone (incl. area code) (478) 855-7##4	Position/Title/Type of Business	Business Phone (incl. area code)		

If employed in current position for less than two years or if currently employed in more than one position, complete the following:

V. MONTHLY INCOME AND COMBINED HOUSING EXPENSE INFORMATION						
Gross Monthly Income	Borrower	Co-Borrower	Total	Combined Monthly Housing Expense	Present	Proposed
Base Empl. Income*	\$ 15,000	\$	\$ 15,000	Rent	\$	
Overtime				First Mortgage (P&I)	1525	\$ 2850
Bonuses				Other Financing (P&I)		
Commissions				Hazard Insurance	200	300
Dividends/Interest				Real Estate Taxes	500	650
Net Rental Income				Mortgage Insurance		
Other (before completing, see the notice in "describe other income," below)				Homeowner Assn. Dues	50	75
				Other:		
Total	\$ 15,000	\$	\$ 15,000	Total	\$ 2,275	\$ 3,875

* Self Employed Borrower(s) may be required to provide additional documentation such as tax returns and financial statements.

Name and address of Company GMAC	\$ Payment/Months 1 \$1,238*	\$ \$30,255
Acct. no. ### #####	Paid by business	
Name and address of Company MBCC	\$ Payment/Months 1 \$1,250*	\$ \$41,875
Acct. no. #####	Paid by business	

Loan Product Advisor Feedback & Guide Reference

Loan Product Advisor Feedback Message

- 1K Signed IRS Form 4506-T: Any borrower, whose income is used to qualify, is required to sign IRS Form 4506-T no later than the Note Date.
- CZ A 10-day pre-closing verification (10-day PCV) for **John Doe** is required for each source of employment income used to qualify. The 10-day PCV must be dated no more than 10 Business Days prior to the Note Date or after the Note Date but prior to the Delivery Date.
- CV Employment/base income for **John Doe** for base non-fluctuating earnings or fluctuating hourly earnings must be supported by a YTD paystub documenting all YTD earnings and W-2(s) for the most recent calendar year, OR a written VOE documenting all YTD earnings and earnings for the most recent calendar year.

Loan Product Advisor messaging for omission of debt

- NA The following debt(s) was submitted as paid off and/or excluded and is therefore omitted from the debt-to-income (DTI) ratio; include evidence to support omission in the mortgage file: Creditor: **GMAC, acct ***1234, Bal, \$30,255; MBCC Acct ***5678, Bal \$41,875**

5401.2: Monthly debt payment-to-income ratio

(b) Liabilities that may be excluded from the monthly debt payment-to-income ratio

(i) Contingent liabilities

A contingent liability may be excluded from the monthly debt payment-to-income ratio when meeting the requirements in the table below. The documentation used to exclude the liability must meet the age of documentation requirements in [Section 5102.4](#).

Debt type	Eligibility and documentation requirements
<ul style="list-style-type: none">• Installment (not including Mortgages)• Revolving• Monthly lease payment	<p>Documentation in the Mortgage file must indicate the following:</p> <ul style="list-style-type: none">• A party other than the Borrower has been making timely payments for the most recent 12 months (regardless of whether the party is obligated on the debt)• The party making the payments is not an interested party to the subject real estate or Mortgage transaction*

Lender Documentation from Borrower

Most recent W-2

4506

Verification of Employment

10-day preclosing VOE

Prior year's tax returns

Docs to support Business paying two debts

Request for Verification of Employment

Privacy Act Notice: This information is to be used by the agency collecting it or its assignees in determining whether you qualify as a prospective mortgagor under its program. It will not be disclosed outside the agency except as required and permitted by law. You do not have to provide this information, but if you do not your application for approval as a prospective mortgagor or borrower may be delayed or rejected. The information requested in this form is authorized by Title 38, USC, Chapter 37 (if VA); by 12 USC, Section 1701 et. seq. (if HUD/FHA); by 42 USC, Section 1452b (if HUD/CPD); and Title 42 USC, 1471 et. seq. or 7 USC, 1921 et. seq. (if USDA/FmHA).

Instructions: Lender – Complete items 1 through 7. Have applicant complete item 8. Forward directly to employer named in item 1.
Employer – Please complete either Part II or Part III as applicable. Complete Part IV and return directly to lender named in item 2.
The form is to be transmitted directly to the lender and is not to be transmitted through the applicant or any other party.

Part I – Request

1. To (Name and address of employer)
Great Widget Corporation
123 Anystreet,
Anytown, ST, #####

2. From (Name and address of lender)
Lender name
Lender Address

I certify that this verification has been sent directly to the employer and has not passed through the hands of the applicant or any other interested party.

3. Signature of Lender
Jennifer Processor

4. Title
Loan Processor

5. Date

6. Lender's Number (Optional)

I have applied for a mortgage loan and stated that I am now or was formerly employed by you. My signature below authorizes verification of this information.

7. Name and Address of Applicant (include employee or badge number)
John Doe, 123 High Street, Anytown, ST

8. Signature of Applicant
John Doe

Part II – Verification of Present Employment

9. Applicant's Date of Employment
July 15, 2016

10. Present Position
General Manager

11. Probability of Continued Employment
Excellent

12A. Current Gross base Pay (Enter Amount and Check Period)

\$15,000
 Annual
 Monthly
 Other (Specify)
 Weekly

12B. Gross Earnings

Type	Year To Date	Past Year	Past Year
Base Pay	Thru 7-22 \$ 81,000.00	\$ 132,000.00	\$ 132,000.00
Overtime	\$	\$	\$
Commissions	\$	\$	\$
Bonus	\$	\$	\$
Total	\$ 81,000.00	\$ 132,000.00	\$ 132,000.00

13. For Military Personnel Only

Pay Grade
Type Monthly Amount

Base Pay \$
Rations \$
Fight or Hazard \$
Clothing \$
Quarters \$
Pro Pay \$
Overseas or Combat \$
Variable Housing Allowance \$

14. If Overtime or Bonus is Applicable, Is its Continuation Likely?
Overtime Yes No
Bonus Yes No

15. If paid hourly – average hours per week

16. Date of applicant's next pay increase
July 15, 2020

17. Projected amount of next pay increase
July 15, 2021

18. Date of applicant's last pay increase
July 15, 2017

19. Amount of last pay increase
\$48,000 annually

20. Remarks (If employee was off work for any length of time, please indicate time period and reason)
Joe has been employed since the company was started.

Part III – Verification of Previous Employment

21. Date Hired

22. Date Terminated

23. Salary/Wage at Termination Per (Year) (Month) (Week)
Base Overtime Commissions Bonus

24. Reason for Leaving

25. Position Held

Part IV – Authorized Signature - Federal statutes provide severe penalties for any fraud, intentional misrepresentation, or criminal connivance or conspiracy purposed to influence the issuance of any guaranty or insurance by the VA Secretary, the U.S.D.A., FmHA/FHA Commissioner, or the HUD/CPD Assistant Secretary.

26. Signature of Employer
[Signature]

27. Title (Please print or type)
Human Resources Manager

28. Date
08/22/2020

29. Print or type name stated in item 26
name redacted for presentation

30. Phone No. ###-###-####

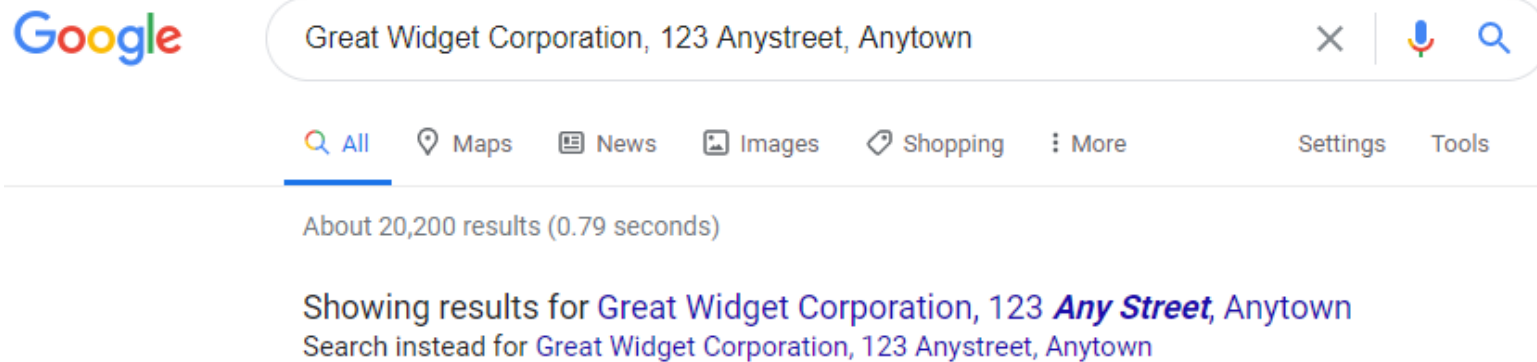
22222	a. Employee's social security number #####-##-####	OMB No. 1545-0008
b. Employer identification number (EIN)	1. Wages, tips, other compensation 132,000	2. Federal income tax withheld \$
c. Employer's name, address, and ZIP code Great Widget Corporation 123 Anystreet, Anytown, ST #####	3. Social security wages 132,000	4. Social security tax withheld \$
d. Control number	5. Medicare wages and tips 132,000	6. Medicare tax withheld \$
e. Employee's first name and initial John Doe	7. Social security tips \$	8. Allocated tips \$
f. Employee's address and ZIP code 123 High Street, Anytown, ST #####	9. Nonqualified plans	10. Dependent care benefits
15. State ST	16. State wages, tips, etc. 132,000	17. State income tax
18. Local wages, tips, etc.	19. Local income tax	20. Locality name

Form **W-2 Wage and Tax Statement** 2019
Department of the Treasury—Internal Revenue Service

VOE indicated the Borrower's salary is \$15,000 monthly, and that his salary in the prior two years was \$132,000 which worked out to \$11,000 monthly.

- tax return matched the \$132,000 income since the salary was increased only a one month before the application date

Red Flag #2



The company's website indicated the names of the company's seven officers, two of whom had the same last name as the Borrower.

Repurchase

CAPACITY

The Borrowers capacity to repay the mortgage was not established.

According to public records, the Borrower founded the Great Widget Corporation in 2016, and he and the co-borrower are officers of the company. Freddie Mac concluded the Borrowers were self-employed.

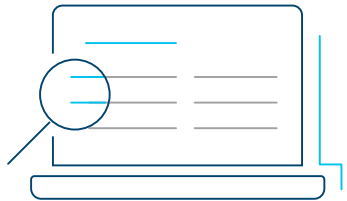
The Guide, Chapter 5304.1, indicates when a Borrower is self-employed in a business for less than five years, the Borrower's income must be documented with two years personal and business tax returns and Form 91. In this case, the file did not contain the necessary documentation to support the Borrower's \$15,000 monthly income.

In addition, Chapter 5401.2 states that when the Borrower's debt is paid by the Borrower's business, the business' tax returns must support that the debt has been paid by the business. In this case, the file contained evidence the Business had paid 12 monthly payments, but the tax returns were not provided so our analysis could not be completed.

The loan is not eligible for sale to Freddie Mac.

Topic 2 – Self-Employed Borrowers in a C-Corporation

Appeal



Year-to-Date
Profit and Loss
statement
compiled by
the CPA

To Whom It May Concern:

I represent the Anytown Accounting Firm. Our company has prepared the personal tax returns for Joe and Jane Doe for many years, and we have prepared the corporate tax returns for the Great Widget Corporation since it was founded in 2016, just over four years ago. Joe Doe, as the founder of the privately held Corporation, holds 35% of the common stock. Jane Doe, his spouse, owns 15% of the common stock. Five other shareholders own the remaining 50% of the common stock.

We have been requested to explain the reasons for Joe's increase in salary that began on July 15, 2020. Great Widget Corporation, under Joe's leadership, has opened a new manufacturing facility in nearby Emerald City which will increase the availability of Widgets to the entire Tri-State area. Joe's new salary reflects his expanded duties as General Manager over both the Anytown and Emerald City locations.

Sincerely,

David Debit, Certified Public Accountant

Guide 5304.1 (d)

5304.1 Stable monthly income and documentation requirements for self-employed Borrowers

(d) Business and income analysis

The following chart contains requirements and guidance pertaining to business and income analysis:

Analysis	
Topic	Requirements and guidance
Business and income analysis	<p>Income calculation</p> <p>The Seller's calculation of a self-employed Borrower's average monthly income must be based on a review of the Borrower's complete federal individual income tax returns (Form 1040) including W-2's and Schedule K-1's (if applicable) and the Borrower's complete federal income tax returns for the business (Forms 1120, 1120 S and 1065), when applicable.</p> <p>The Seller must analyze the tax returns and document the calculation of the Borrower's self-employed income on Form 91, Income Calculations, or a similar alternative form.</p>
Business financial statements	<p>Business financial statements typically consist of a profit and loss statement and a balance sheet for the business that cover a specified period of time (e.g., YTD, annual).</p> <ul style="list-style-type: none">Financial statements for the business may be prepared by multiple parties, including but not limited to, the Certified Public Accountant (CPA), accountant or tax preparer that prepares the tax returns for the business, or the BorrowerFinancial statements may not be used for the calculation of stable monthly income (unless audited); however, they may provide additional support for the Seller's business and income analysisFinancial 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

Scenario One – Takeaways

01

Investigate Red Flags

02

Personal tax return may not disclose a Borrower's self-employment

03

If the Borrower needs corporate income in addition to the W-2 income, there are additional steps necessary as outlined in the Guide, Section 5304.1

- analysis of the impact to the business if the business income were used as personal income
- documentation that the Borrower has the rights to the business income

04

The qualifying income must be supported by the tax returns



Questions?

**Topic 3 – Self-Employed
working for a Family Member
Owned Business**

Loan Product Advisor Feedback & Loan Application

Loan Product Advisor messaging required lender to obtain W2 and paystub.

CZ A 10-day pre-closing verification (10-day PCV) for [REDACTED] is required for each source of employment income used to qualify. The 10-day PCV must be dated no more than 10 Business Days prior to the Note Date or after the Note Date but prior to the Delivery Date.

CV Employment/base income for [REDACTED] for base non-fluctuating earnings or fluctuating hourly earnings must be supported by a YTD paystub documenting all YTD earnings and W-2(s) for the most recent calendar year, OR a written VOE documenting all YTD earnings and earnings for the most recent calendar year.

Loan application

Borrower		IV. EMPLOYMENT	
Name & Address of Employer Homebuyer Manufacturing Corp 123 Main Street		<input type="checkbox"/> Self Employed	Yrs. on this job 4
Position/Title/Type of Business Operations Manager		Yrs. employed in this line of work/profession 4	
Business Phone (incl. area code) 555-555-5115			

If employed in current position for less than two years or if currently employed in more than one position

Topic 3 – Self-Employed working for a Family Member Owned Business

Qualifying Income Documents

- Qualifying income as \$11,000 per month into Loan Product Advisor, which would amount to \$132,000 annually in base salary.
- W-2 from the previous year reflects total earnings of \$88,000.
- The current paystub does reflect semi-monthly base pay of \$5,500 per pay period.

22222	Void <input type="checkbox"/>	a Employee's social security number XXX-XX-XXXX	For Official Use Only ▶ OMB No. 1545-0008
b Employer identification number (EIN)		1 Wages, tips, other compensation	
EIN		\$88,000.00	
c Employer's name, address, and ZIP code		3 Social security wages	
Homebuyer Manufacturing Corp		\$88,000.00	
123 Main Street		555-555-5115	5 Medicare wages and tips
			\$88,000.00

COMPANY		Earnings Statement	
Homebuyer Manufacturing Corp		Period Beginning:	4/1/2020
123 Main Street		Period Ending:	4/15/2020
		Pay Date:	4/16/2020
EMPLOYEE John Homebuyer			
ADDRESS 555 Spring Street			
SOCIAL SECURITY NO.		PAY RATE	
XXX-XX-		\$5,500 regular	
		overtime	
EARNINGS		HOURS	AMOUNT
Regular			\$5,500
Overtime			\$0
DEDUCTIONS		AMOUNT	
Federal W/H		\$1,373	
Medical Insurance		\$250	
Medicare		\$50	

Guide 5301.1 (c)

5301.1 General requirements for all stable monthly income

(c) Income stability and history requirements

The Seller must consider the length of history of the income and whether the earnings have been level and consistent. When evaluating stability of income based upon historical receipt, additional layering of risk may be present depending upon the degree of income fluctuation. **As a result, the Seller must determine when additional documentation (e.g., an additional year of earnings history) is necessary to support income stability.**

In most instances, a two-year history of receiving a consistent level of income is required in order for the income to be considered stable and used for qualifying. While the source of income may vary, the Borrower must have a consistent level of income despite changes in the sources of income. **If 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.**

Refer to Section 5303.4 for income calculation guidance and requirements.

Topic 3 – Self-Employed working for a Family Member Owned Business

Red Flags



Form 90

Verbal Verification of Employment

Borrower name:	John Homebuyer
Employer name:	Homebuyer Manufacturing Corp
Employer contact:	Ron Homebuyer
Employer contact title:	President / CEO
Phone number:	555-555-5115
Third party source used to obtain the phone number:	411.com
Borrower's current employment status:	active
Additional information (If applicable):	John is part owner of the company.
Verified by:	Joe Processor
Date:	5/1/2020

- The Borrower (John Homebuyer) works for a company called Homebuyer Manufacturing Corp with the person who completed the Verification having the same last name as the Borrower (Ron Homebuyer).
- The person who completed the VOE also indicated the Borrower does have ownership interest in Homebuyer Manufacturing Corp.

Guide 5302.4 (c)

5302.4 Tax returns and tax return information: Documentation and verification requirements

(c) When tax returns are required

The Seller must obtain the Borrower's most recent federal income tax return(s) for certain types of income and/or employment characteristics if using the income to qualify the Borrower. Links to the topic specific requirements are provided in the chart.

Income types and/or employment characteristics	Location
Tip income – Cash and charge tips reported on IRS Form 4137	Section 5303.3
Income from employment by a family member, property seller, broker or other interested party to the transaction	Section 5303.2(d)
Employed income from a foreign source	Section 5303.2(d)
Income reported on IRS Form 1099	Section 5303.2(d) , Chapter 5304
Self-employed income	Chapter 5304
Dividend and interest income	Section 5305.2

Topic 3 – Self-Employed working for a Family Member Owned Business

Appeal

Schedule K-1 (Form 1120-S) Department of the Treasury Internal Revenue Service

2019 For calendar year 2019, or tax year beginning 01 / 01 / 2019 ending 12 / 31 / 2019

Shareholder's Share of Income, Deductions, Credits, etc. ▶ See back of form and separate instructions.

Part I Information About the Corporation		Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items	
A Corporation's employer identification number XXXX	1 Ordinary business income (loss) \$48,000	13 Credits	
B Corporation's name, address, city, state, and ZIP code Homebuyer Manufacturing Corp 123 Main Street	2 Net rental real estate income (loss)		
C IRS Center where corporation filed return XXX	3 Other net rental income (loss)		
	4 Interest income		
	5a Ordinary dividends		
	5b Qualified dividends	14 Foreign transactions	
	6 Royalties		
	7 Net short-term capital gain (loss)		
	8a Net long-term capital gain (loss)		

Part II Information About the Shareholder	
D Shareholder's identifying number XXXX	
E Shareholder's name, address, city, state, and ZIP code John Homebuyer 555 Spring St	
F Shareholder's percentage of stock ownership for tax year	22.00 %

They were able to provide the previous two years of tax returns which contained the schedule K-1 reflecting the Borrower having a 22% ownership interest in the business for both tax filing years. The K-1 did reflect business income in the amount of \$48,000 for each of the previous two years.

Guide 5303.2(d)

5303.2 Primary and secondary employment and income

(d) Employment characteristics

For all employment characteristics below, the Seller must determine whether the employment represents primary or secondary employment and use the applicable requirements for history, continuance, earnings type, documentation and calculation in this chapter and in conjunction with Chapters 5301 and 5302, unless specifically stated otherwise. For certain employment characteristics, additional documentation and/or analysis may be needed, as described below.

Employment characteristics		Additional requirements
Borrower employed by a family member or by the property seller, real estate broker or other interested party to the transaction	When a Borrower is employed by a family member or by an interested party to the transaction, the employment and income is not arm's length. Due to the increased layering of risk inherent in non-arm's length transactions, further in-depth analysis is required to determine stability of the income.	Complete signed federal individual income tax return for the most recent year

Scenario Two – Takeaways

01

Use caution whenever a Borrower receives a significant pay increase in the current year

02

Look for red flags on loan documentation such as inconsistencies on the Verbal Verification of Employment

03

Obtain most recent year tax returns for Borrowers working for family members

Summary

Key Takeaways

01

Know your Borrower's employment status

03

Document the income according to the Guide

02

Look out for Red Flags

04

If tax returns are required to calculate income, raises that occurred after the last tax return filed should not be used to qualify



Questions?

Topic 4 – Underwriting Self- Employed Borrowers During COVID-19

Topic 4 – Underwriting Self-Employed Borrowers During COVID-19

Content Overview

01

Supporting Market Liquidity & Development Background

02

Identifying Factors to Consider

03

SE Income – Pandemic Data Snapshot (U.S. Census Bureau)

04

Guidance for the Application of Pandemic Requirements

05

Key Reminders

Supporting Market Liquidity | Development Background

Supporting Market Liquidity while Promoting Sustainable Homeownership

“Income from a business that has been negatively impacted by changing conditions is not necessarily ineligible for use in qualifying the borrower. However, the lender is required to determine if the borrower’s income is stable and has a reasonable expectation of continuance.”

COVID-19 Announcements – General Development Background

- **GSE Alignment** - Beneficial to industry to avoid the application of differing requirements
- **Baseline** - Provide baseline requirements and industry guidance for the unusual circumstances presented by the pandemic
- **Pandemic Impacts** - Develop guidance that can be applied to multiple types of pandemic impacts to businesses
- **Latitude** - Maintain sufficient latitude to enable lenders to continue to address each transaction on an individual basis
- **GSE review and discussion ongoing** - continuously changing pandemic and economic conditions

Identifying Factors | 3 Primary Business Scenario Segments

IDENTIFYING FACTORS TO CONSIDER – BUSINESS SCENARIO SEGMENTS

Determining the extent to which a business has been impacted by COVID-19

Pandemic Impacts to Businesses 3 Primary Business Scenario Segments			
Segment		Example	Actionable Insight
1	Business Open & Operating	<p>2020 Revenue Not Negatively Impacted <i>(e.g., stable to increasing)</i></p>	<ul style="list-style-type: none"> ▪ Confirm not negatively impacted by following Bulletin requirements (e.g., YTD P&L, Business Bank Statements, Pandemic Related Factors, 2019-2020 tax return with business analysis) ▪ Proceed using standard guide (pre-pandemic) methods (use of tax returns to qualify)
2	Business Open & Operating	<p>2020 Revenue Negatively Impacted <i>(operating at reduced capacity)</i></p>	<ul style="list-style-type: none"> ▪ Close review needed ▪ Supplemental Documentation likely needed
3	Business Closed <i>and/or</i> Recently Re-opened	<p>Closed, Recently Re-opened <i>(closed by mandate)</i></p>	<ul style="list-style-type: none"> ▪ Recently Re-opened <ul style="list-style-type: none"> • Close review needed • Supplemental Documentation likely needed • If recently re-opened, may not have enough documentation to support a stable revenue/expense flow; many unknowns ▪ Closed – ineligible income

Identifying Factors | Pandemic Related Factors to Consider

Determining the extent to which a business has been impacted by COVID-19

Examples – Refer to [Bulletin 2020-44](#)

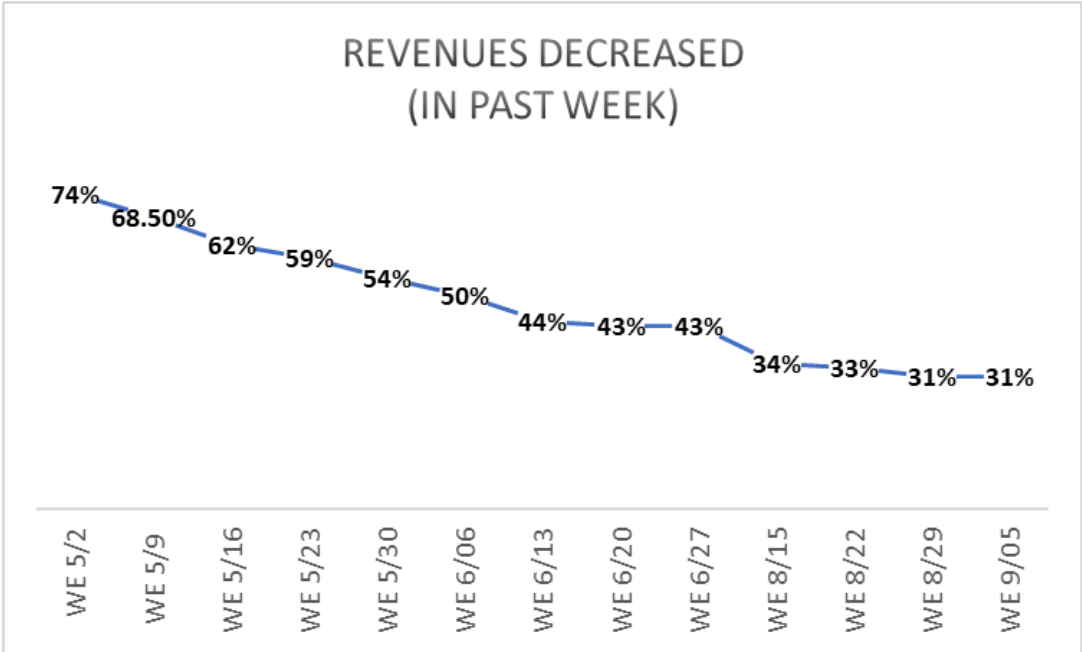
Seller must consider pandemic-related factors which may include, but are not limited to, the following:

- If temporary restrictions have been recently lifted, will the business continue to operate at a reduced level of revenue due to COVID-19-related factors, such as social distancing? If so, has the business been operating at this reduced level of revenue and/or increased level of expenses for a long enough period to establish income stability and is this documented with more recent business bank account statements evidencing this revenue flow or other equivalent information?
- If the ability of the business to generate revenue or operate at full capacity has been negatively impacted by the pandemic, have business operations been maintained or modified to support continued business revenue? Is continued business revenue supported by any other documentation or information supplied by the Borrower (e.g., updated business plan) or obtained from other sources?
- **Additional economic information related to the business such as:**
 - Whether the business is part of an industry that is experiencing increasingly negative pandemic-related impacts
 - Whether the business type is in what is considered a high contact-intensive industry and if the higher risk of exposure to COVID-19 may present an impact to the potential for income stability and/or continuance until the medical issues surrounding the pandemic are closer to being resolved, whether or not there are State or local orders that temporarily restrict the business operation

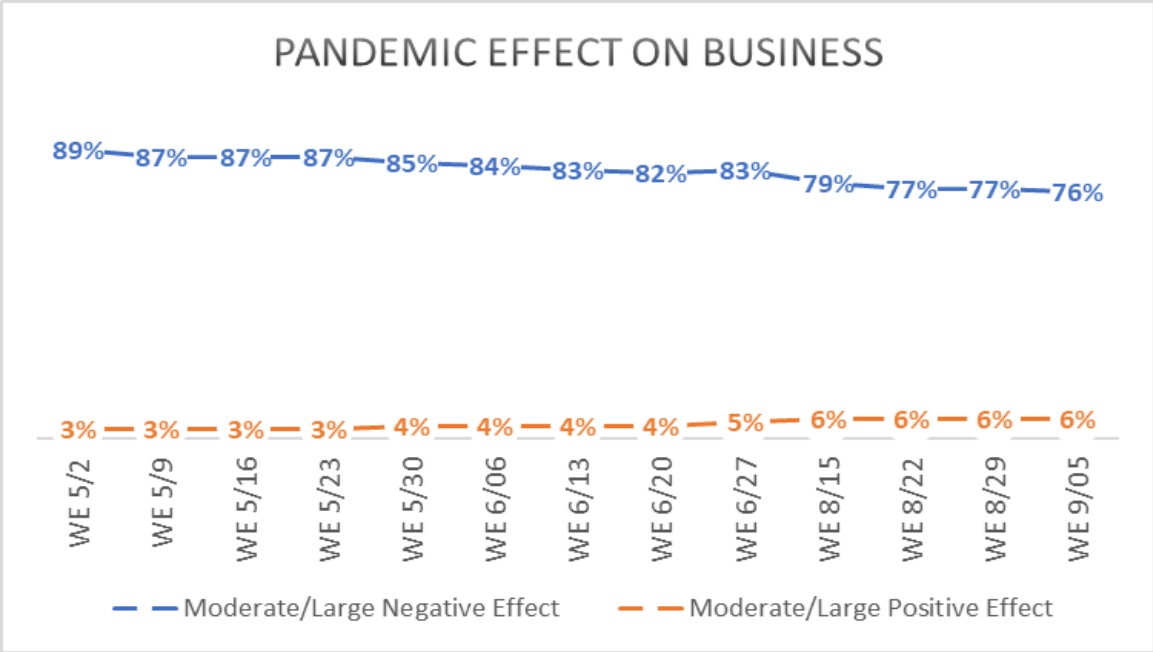
U.S Census Bureau | Small Business Pulse Survey (SBPS)

PANDEMIC DATA SNAPSHOT

Census Survey Question: *In the last week*, did this business have a change in operating revenues/ sales/receipts, not including any financial assistance or loans?



Census Survey Question: Overall, how has this business been affected by the Coronavirus pandemic?



Baseline Requirement Excerpts

Baseline Requirement Excerpts		
1.	Impact Business Segment	Review the YTD profit and loss statement (unaudited or audited), business account statements, and all other relevant factors and documentation <u>to determine the extent to which a business has been impacted by COVID-19.</u>
2.	Supplemental Documentation	Additional documentation may be needed to <u>supplement the minimum required documentation</u> in order to effectively assess the impact of the pandemic on the business.
3.	Consistency Review	Revenues shown on YTD P&L and Business Bank Statements must be <u>reasonably consistent</u>
4.	Comparison	Determine <u>whether the income level has declined</u> <u>by comparing</u> the information on the YTD profit and loss statement to the business revenue (i.e., gross receipts or sales) <u>reported on the most recent year's business tax return(s)...</u>
5.	Calculation	<u>Establish the current level of stable monthly self-employment income</u> using details from the YTD profit and loss statement, business account statements, and <u>supplemental documentation, as applicable.</u>

Documentation: Minimum – Supplemental | Review Guidance

Minimum Documentation – Is it enough?

- Unaudited signed YTD P&L and
- 3 months business bank statements dated no more than 60 days prior to note date

Additional documentation may be needed to supplement the minimum required documentation in order to effectively assess the impact of the pandemic on the business.

Supplemental Documentation – Is it needed?

Consider Identifying Factors, Business Segments and Dates when determining if Supplemental Documentation is applicable

- It is highly likely supplemental documentation may be necessary to perform an effective income analysis when:
 - Business revenue and/or operations are negatively impacted (e.g., restricted, revenues declining year-over-year) due to the pandemic
- **Supplemental Documentation Examples:** Additional (more recent) online bank statements, complete 2020/2021 online bank statements, month-to-month or quarterly trending analysis on YTD P&L, Balance Sheet (financial statement vs. P&L), Quarterly tax returns

YTD P&L – Business Bank Statements | Review Guidance

YTD P&L Statements – Review Guidance	
Dates - Quarterly	<p>Quarterly P&L Statements are recommended to enable a comprehensive analysis –</p> <ul style="list-style-type: none"> • Provides clearer view of revenue throughout the various pandemic stages (e.g., non-pandemic (Q1 2020), pandemic fluctuations based on varying restrictions) • Supports full assessment of the degree in which the business revenue is/was negatively impacted by the pandemic
Balance Sheet	<p>A balance sheet (complete financial statement) may be beneficial in determining COVID-19 related assistance, current assets, and liabilities when performing the business analysis.</p>

Business Bank Statements – Review Guidance	
Business Revenue Defined	<ul style="list-style-type: none"> ▪ Represents gross receipts or sales, as reported on the business tax returns ▪ Does not include proceeds from Payroll Protection Program (PPP) loans or other COVID-19 related loans or assistance as these represent short-term economic relief and are not revenue (e.g., business income)
Decreased Revenue Pandemic Impact	<p><u>Supplemental Documentation:</u> It is likely supplemental documentation (e.g., more recent online bank statements, month-to-month or quarterly YTD P&L trending analysis for a clearer view) is necessary to obtain a current assessment of the business revenue</p>
Fixed Expenses	<p><u>Spot Check:</u> Do fixed expenses appear on the business bank statements (e.g., rent/mortgage, payroll, utilities)?</p>
Totals Compare	<ul style="list-style-type: none"> ▪ Review the sum total of deposits (e.g., monthly, quarterly) to enable a comparison against the YTD P&L details ▪ Revenues shown on YTD P&L and Business Bank Statements must be reasonably consistent ▪ Compare 2020/2021 revenues to revenues confirmed on prior year business tax return

Summary

Key Takeaways

01

Written Income Analysis

02

Determine business segment

- If impacted, supplemental documentation is likely relevant

03

Dates and the most recent information are important

04

Focus on pandemic revenue impact

Ensure the 2020 tax returns are obtained as soon as they become available

05

Stay knowledgeable of [FAQs](#)

Please provide feedback



Questions?

Additional Resources



[Freddie Mac Learning](#)

[Webinar – COVID-19 Temporary Appraisal Guidelines](#)

[Interactive Tool – Temporary Credit Requirements and Appraisal Flexibilities](#)

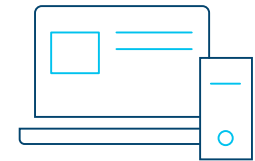
[COVID-19 Training Resources](#)

[Webinar Calendar](#)



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Let's QC Quarterly Call Series – Community Lending

Thank You