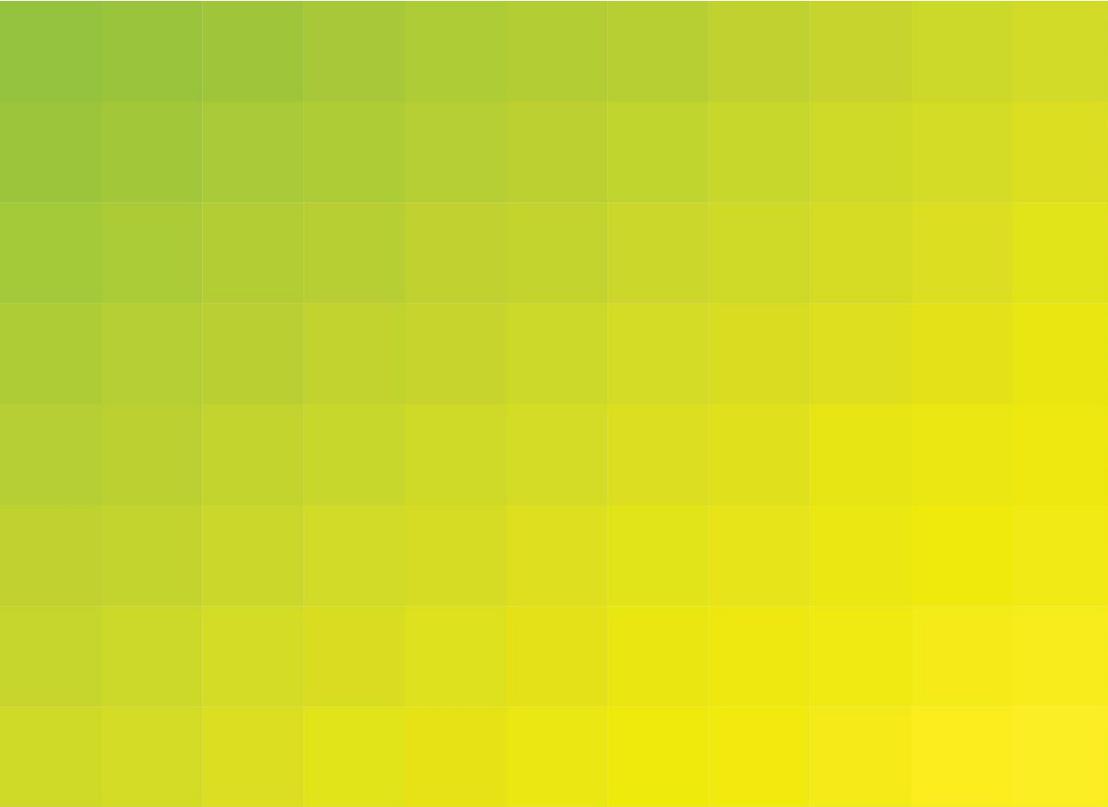


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Policy on Point (POP) Call Series: Assets as a Basis for Repayment of Obligations, Rental Income and Other Income Updates



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June 13, 2019

Assets as a Basis for Repayment of Obligations, Rental Income and Other Income Updates

- Topic 1 – Assets as a Basis for Repayment of Obligations (ABRO)
- Topic 2 – Rental Income
- Topic 3 – Other Income Related Updates
- Resources
- Customer Survey



The **‘why’** behind the policy and the **‘how,’** including applying a recent change we made in April 2019

Guide Section 5307.1

Assets as a basis for repayment of obligations

Effective 04/03/2019

Refer to Guide Bulletin 2019-7, which announced revisions to the calculation for establishing the debt payment-to-income ratio for assets as a basis for repayment of obligations, which can be implemented prior to the July 3, 2019 version of this section.

Assets that will be used by the Borrower for the repayment of their monthly obligations may be used to qualify the borrower for the Mortgage, provided that the requirements of this section are met.

Assets as a basis for repayment of obligations (ABRO)

Permits assets be used to qualify the Borrower:

- ✓ Converting those assets into an amount that can be added to the debt payment-to-income ratio.
- ✓ Funds in eligible asset accounts will be used to REPAY obligations, including the Mortgage debt, so can be considered in the overall evaluation.

Intent: To allow a Borrower to qualify using assets that will likely be used to repay the mortgage obligation

Target Borrower: Retirees

Loan Scenario: 62-year-old, recently retired Borrower receiving social security income only. They have a sizeable amount of funds in 401k accounts.

Given their decreased income, they are likely to use funds in asset accounts to pay for their debt obligations (including the Mortgage debt)





Mortgage eligibility requirements:

1. Mortgage must be secured by a 1- or 2-unit Primary Residence or second home
2. Mortgage must be a purchase transaction mortgage or “no cash-out” refinance Mortgage
3. The Mortgage must have a maximum loan-to-value (LTV)/total LTV (TLTV)/Home Equity Line of Credit (HELOC) TLTV (HTLTV) ratio of 80%

- **Retirement assets (401k, IRAs)**
 - » Borrower must have “penalty-free” access to the funds
 - As of the Note Date, the Borrower must be able to withdraw funds in their entirety, less any portion pledged as collateral for a loan or otherwise encumbered, without being subject to a penalty or early distribution tax
 - » Asset must NOT currently be used as a source of income
 - We permit retirement account distributions to be used as income in accordance with the requirements of Guide Section 5305.2



- **Depository accounts** (e.g., checking, savings accounts) **and securities** (e.g., mutual funds)
 - » At least one Borrower who is an account owner must be at least 62 years old



- Access to retirement accounts are generally restricted by the IRS until the owner is age 59 ½ or older. Therefore, allowing that asset type aligns with intent of policy and our target Borrower.
- There is typically no restriction to access funds in depository accounts and securities. The Borrower can withdraw those funds at any time for any reason, whether they are retired or not.
- Permitting use of depository accounts and securities was introduced in 2017 and was an expansion of the policy.



- **Depository accounts (e.g., checking, savings accounts) and securities (e.g., stocks, bonds mutual funds)**
 - » At least one borrower who is an account owner must be at least 62 years old
 - » The Borrower must solely own asset or, if asset is owned jointly, each asset owner must be a Borrower on the Mortgage and/or on the title to subject property

**For additional asset types and eligibility requirements please see Guide Section 5307.1*

Net eligible assets / single number denominator



How to calculate *net eligible assets*:

Funds in the eligible asset types subtracted by:

- a) Funds required to complete the transaction (e.g., closing costs, down payment)
- b) Gift funds and borrowed funds
- c) Any portion of assets pledged as collateral for a loan or otherwise encumbered



The change was announced in April 2019 and must be implemented beginning 07/03/19, but can be implemented anytime before then



 The calculation is now **NET eligible assets / 240**

Where does the 240 come from and how does that compare to what it was BEFORE the change?

- ✓ Our calculation is concerned with asset preservation
- ✓ We received client feedback that the previous denominator of 360 was too conservative
- ✓ The denominator of 240 is appropriate based on our analysis which considered a number of factors including:
 - Duration of the Borrower's retirement
 - Rate of usage of assets and ease of implementation of the calculation



The calculation is now:

net eligible assets

240

Example #1: Retirement Assets

Purchase transaction Mortgage secured by a 1-unit Primary Residence: \$200,000 Mortgage

Funds required to complete transaction: \$10,000

1 Borrower: 60 years old

Retirement asset 401k account: \$161,332.09 fully vested

YOUR HUMANA RETIREMENT SAVINGS PLAN STATEMENT

Period covered: JANUARY 1, 2015 TO MARCH 31, 2015

Your Account Value **\$161,332.09**

Change in Account Value

	This Period	This Year
Beginning Value	\$147,718.82	\$147,718.82
Your Contributions	4,297.54	4,297.54
Employer Contributions	6,658.35	6,658.35
Individual Transaction Fees*	0.00	0.00
Plan Administration and Other Fees*	(17.75)	(17.75)
	2,675.13	2,675.13
Ending Value	\$161,332.09	\$161,332.09
Vested Amount	\$161,332.09	

go to workplace.schwab.com under the History tab.

Your Positions

Capital Preservation Funds 2%
Bonds & Bond Funds 33%
Asset Allocation 16%
Stocks & Stock Funds 49%

Your Positions chart shows how your account is divided among the different types of assets within your retirement plan account.

Account History in thousands

Your contributions may not reflect withdrawals taken from your account. Data points represent value as of the last business day of the month shown and do not reflect volatility between months. The Account History chart illustrates the long-term performance of your account.

Humana.

Contact Us
Schwab Retirement Plan Services, Inc.
Call 800-724-7526
Monday - Friday 7:00 a.m. to 11:00 p.m.
Eastern Time (ET)
workplace.schwab.com

Go paperless.
Sign up to receive your retirement plan communications electronically to stay on top of your account details and activity. Call Participant Services at 1-800-724-7526 or visit workplace.schwab.com.

The asset calculation for establishing debt payment-to-income ratio:

$$\frac{\$161,332.09 - \$10,000 \text{ (net eligible assets)}}{240} = \$630.55$$

240

= \$630.55

Example #2: Retirement Assets with a Twist



Purchase transaction Mortgage secured by a 1-unit Primary Residence: \$200,000 Mortgage

Funds required to complete transaction: \$10,000

1 Borrower: 60 years old

Retirement asset 401k account: \$400,000 fully vested

The asset calculation for establishing debt payment-to-income ratio:

N/A

IRA F
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ROLLOVER ACCOUNT

December 1, 2018 - December 31, 2018
Account Number -----

Your Financial Advisor Is: 

Portfolio at a Glance

	This Period	Year-to-Date
BEGINNING ACCOUNT VALUE	\$427,922.20	\$0.00
Deposits (Cash & Securities)	0.00	503,136.29
Withdrawals (Cash & Securities)	-10,000.00	-60,000.00
Dividends, Interest and Other Income	15,185.68	23,950.66
Fees	-398.53	-2,897.19
Other Transactions	-2,195.12	-13,170.72
Net Change in Portfolio¹	-30,004.41	-50,509.22
ENDING ACCOUNT VALUE	\$397,917.79	\$390,500.88
Estimated Annual Income	\$9,446.44	

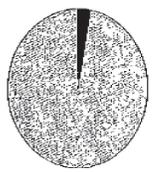
¹ Net Change in Portfolio is the difference between the ending account value and beginning account value after activity.

The Bank Deposits in your account are FDIC insured bank deposits.
FDIC insured bank deposits are not securities and are not covered by the Securities Investor Protection Corporation (SIPC). These bank deposits are covered by the Federal Deposit Insurance Corporation (FDIC), up to allowable limits.

Asset Summary

Percent	Asset Type	Last Period	This Period
3%	Cash, Money Funds, and Bank Deposits	14,433.98	11,905.66
97%	Mutual Funds	413,488.22	388,524.16
100%	Account Total (Pie Chart)	\$427,922.20	\$400,509.82

Please review your allocation periodically with your Financial Advisor.



Example #3: Retirement and Depository Accounts



Purchase transaction Mortgage secured by a 1-unit Primary Residence: \$400,000 Mortgage

Funds required to complete transaction: \$100,000

2 Borrowers: each is 65 years old

Retirement asset 401k account: \$500,000 fully vested

Depository asset accounts: \$600,000

The asset calculation for establishing debt payment-to-income ratio:

$$\frac{\$1,100,000 - \$100,000 \text{ (net eligible assets)}}{240} = \$4,166.67$$


Example #4: Retirement Accounts and Depository Accounts with a Twist



Purchase transaction Mortgage secured by a 1-unit Primary Residence: \$400,000 Mortgage

Funds required to complete transaction: \$100,000

1 Borrower: 65 years old

Retirement asset 401k account: \$500,000 fully vested

Depository asset accounts: \$600,000. There is a joint owner on the depository asset account. The other owner of the \$600,000 is not a Borrower.

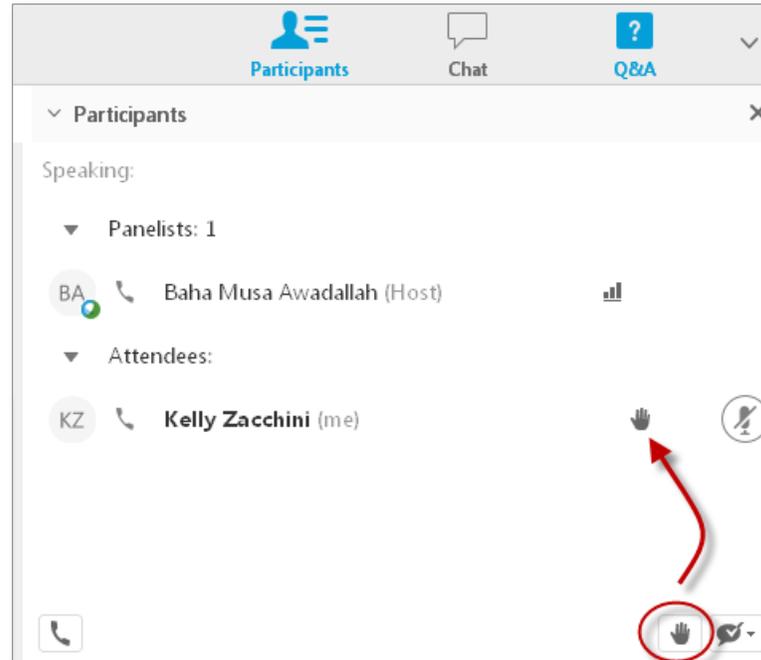
The asset calculation for establishing debt payment-to-income ratio:

$$\text{\#1: } \frac{\$500,000 - \$100,000}{240} \text{ (net eligible assets)} = \$1,666.67$$

$$\text{\#2: } \frac{\$1,100,000 - \$100,000}{240} \text{ (net eligible assets)} = \$4,166.67$$

- Our assets as a basis for repayment of obligations policy permit sellers to qualify a Borrower using assets that will be used for repayment of the Mortgage by calculating an amount that can be added to the debt payment-to-income ratio
- The asset calculation for establishing the debt payment-to-income ratio is: net eligible assets divided by 240
- Eligible asset types include: retirement assets, depository accounts, and securities
- Key eligibility requirements for using the asset types include:
 - » *Retirement accounts:*
 - Borrower’s rights to the funds in the accounts must be fully vested
 - The Borrower must have access to withdraw the funds in their entirety without being subject to a penalty or an additional early distribution tax
 - » *Depository accounts and securities:*
 - At least one Borrower who is an account owner must be at least 62 years old
 - The Borrower must solely own assets or, if asset is owned jointly, each asset owner must be a Borrower on the Mortgage and/or on the title to the subject property

To ask a question...
Raise your hand. Your line will be unmuted.



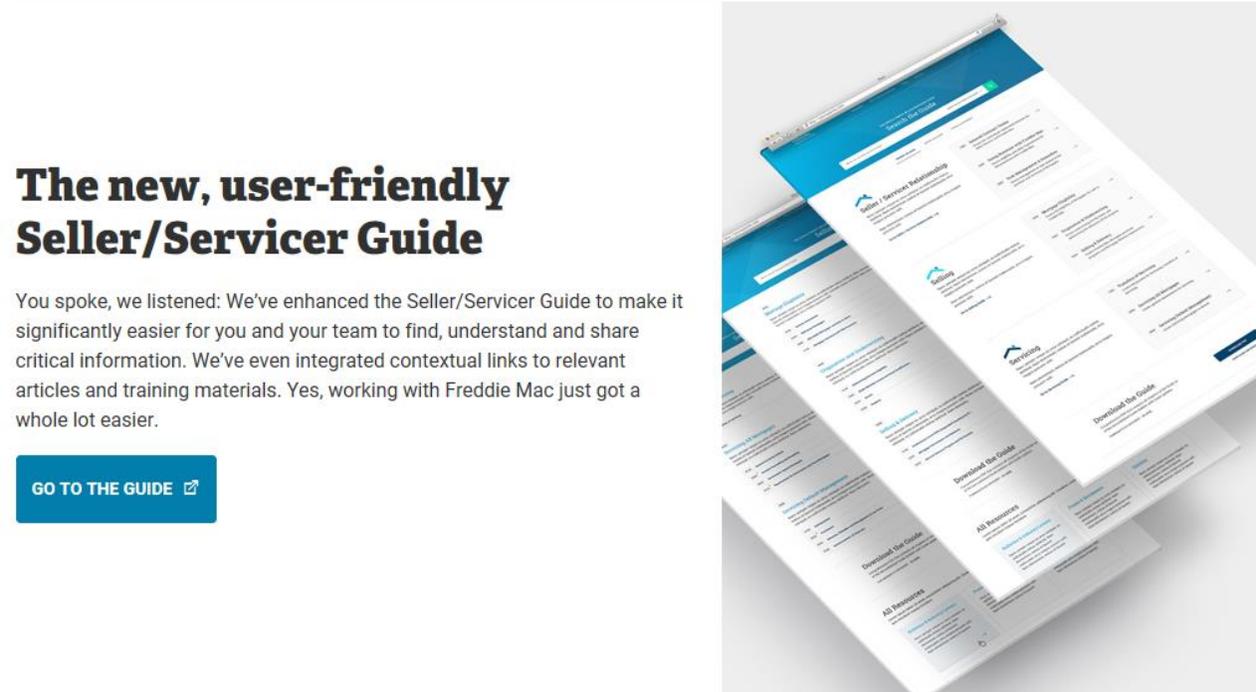
Rental income

- Changes/updates recently made
- Why they were made

Bulletin 2017-12 Rental Income Revisions
08/09/2017



Guide Bulletin 2018-19, and became effective for loans sold to Freddie Mac on or after March 1, 2019



The new, user-friendly Seller/Service Guide

You spoke, we listened: We've enhanced the Seller/Service Guide to make it significantly easier for you and your team to find, understand and share critical information. We've even integrated contextual links to relevant articles and training materials. Yes, working with Freddie Mac just got a whole lot easier.

[GO TO THE GUIDE](#)



Borrower must own a Primary Residence in order to use rental income to qualify when purchasing an investment or rental property



Borrower

- ✓ Borrower lives rent free
- ✓ Wants to purchase a home for \$115,000 with 20% down

- Occupancy: Owner Occupied
- Total Income: \$3,000/monthly
- Total Other Monthly Debt: \$1,200/month
- PITI Payment: \$631
- DTI: 61%

- Occupancy: Investment (**Reverse Occupancy**)
- Total Income: \$3,000/monthly
- Total Other Monthly Debt: \$1,200/month
- Gross Monthly Rent: \$750/apply 25% vacancy factor
- DTI: 42%

Effective March 1, 2019, rental income from the purchase of a subject 1- to 4-unit Investment Property can only be used with the following conditions: Guide impact: Section 5306.1(c)(ii)

- ✓ The Borrower must own a Primary Residence.
- ✓ There's a limit as to how much rental income can be used to qualify (in some instances).
- ✓ The Borrower must have a documented history of managing rental properties to use any rental income over and above the monthly payment when qualifying.



Previously, if the Borrower did not have a minimum one-year history of investment property management experience within the most recent 36 months, net rental income was limited to 30% of the sum of the net rental income AND all other stable monthly income that was used to qualify

Changes announced in Bulletin 2018-19 for property management experience:

- ✓ There is no time limit on the one year experience
- ✓ Borrower may no longer own that property, but it must be documented





If the Borrower has the required investment property management experience, and the net rental income exceeds the full monthly payment of the new investment property, then the excess rental income can be added to the Borrower's gross monthly income



Borrower

Step #1 – Does the Borrower own his or her Primary Residence?

“**yes**” - Rental income may be used to qualify

“**no**” - Borrower must be qualified with the full monthly payment

Step #2 – Does the Borrower have a documented history of managing investment properties?

“**yes**” - Rental income from the subject property, documented in accordance with Guide Section 5306.1, may be used to qualify the Borrower without limitation

“**no**” - Excess rental income cannot be added to the Borrower's gross monthly qualifying income



Knowledge Check

A Borrower, who is on title to their Primary Residence but, not on the mortgage, is purchasing an Investment Property.

They have owned rental properties in the past, but do not own any currently.

They have provided their 2016 federal income tax return, which reflects an investment property, rented for the full year, to document their history of owning and managing investment properties.

SCHEDULE E (Form 1040) Supplemental Income and Loss
 (From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)
 Department of the Treasury Internal Revenue Service (IRS)
 Name(s) shown on return: **Frederick Mack**
 OMB No. 1545-0074
2016
 Attachment Sequence No. **13**
 Your social security number: **999-99-9999**

Part I Income or Loss From Rental Real Estate and Royalties Note: If you are in the business of renting personal property, use Schedule C or C-EZ (see instructions). If you are an individual, report farm rental income or loss from Form 4835 on page 2, line 40. Attach to Form 1040, 1040NR, or Form 1041. Information about Schedule E and its separate instructions is at www.irs.gov/schedulee.

A Did you make any payments in 2016 that would require you to file Form(s) 1099? (see instructions) Yes No
B If "Yes," did you or will you file required Forms 1099? Yes No

1a Physical address of each property (street, city, state, ZIP code)
A 123 Main Street, Anytown USA Yes No
B Yes No
C Yes No

Type of Property (from list below)	2 For each rental real estate property listed above, report the number of fair rental and personal use days. Check the QJV box only if you meet the requirements to file as a qualified joint venture. See instructions.	Fair Rental Days		Personal Use Days	QJV
		A	B	C	<input type="checkbox"/>
A 1		365		0	<input type="checkbox"/>
B					<input type="checkbox"/>
C					<input type="checkbox"/>

Type of Property:
 1 Single Family Residence 3 Vacation/Short-Term Rental 5 Land
 2 Multi-Family Residence 4 Commercial 6 Royalties 7 Self-Rental

Income:	Properties:			8 Other (describe)
	A	B	C	
3 Rents received				
4 Royalties received				
5 Advertising				
6 Auto and travel (see instructions)		12,000		
7 Cleaning and maintenance				
8 Commissions				
9 Insurance				
10 Legal and other professional fees		1,200		
11 Management fees				
12 Mortgage interest paid to banks, etc. (see instructions)		960		
13 Other interest				
14 Repairs				
15 Supplies		3,284		
16 Taxes				
17 Utilities				
18 Depreciation expense or depletion		1,600		
19 Other (list) ▶				
20 Total expenses. Add lines 5 through 19		4,235		
21 Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file Form 6198		11,464		
22 Deductible rental real estate loss after limitation, if any, on Form 8582 (see instructions)				
23a Total of all amounts reported on line 3 for all rental properties		536		
23b Total of all amounts reported on line 4 for all royalty properties				
23c Total of all amounts reported on line 12 for all properties		3,284		
23d Total of all amounts reported on line 18 for all properties		4,235		
23e Total of all amounts reported on line 20 for all properties		11,464		
24 Income. Add positive amounts shown on line 21. Do not include any losses from line 22. Enter total losses here if Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2		536		
25 Losses. Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here if Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2				
26 Total rental real estate and royalty income or (loss). Combine lines 24 and 25. Enter the result here if Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Form 1040, line 17, or Form 1040NR, line 18. Otherwise, include this amount in the total on line 41 on page 2		536		

For Paperwork Reduction Act Notice, see the separate instructions.
 Cat. No. 11344L
 Schedule E (Form 1040) 2016

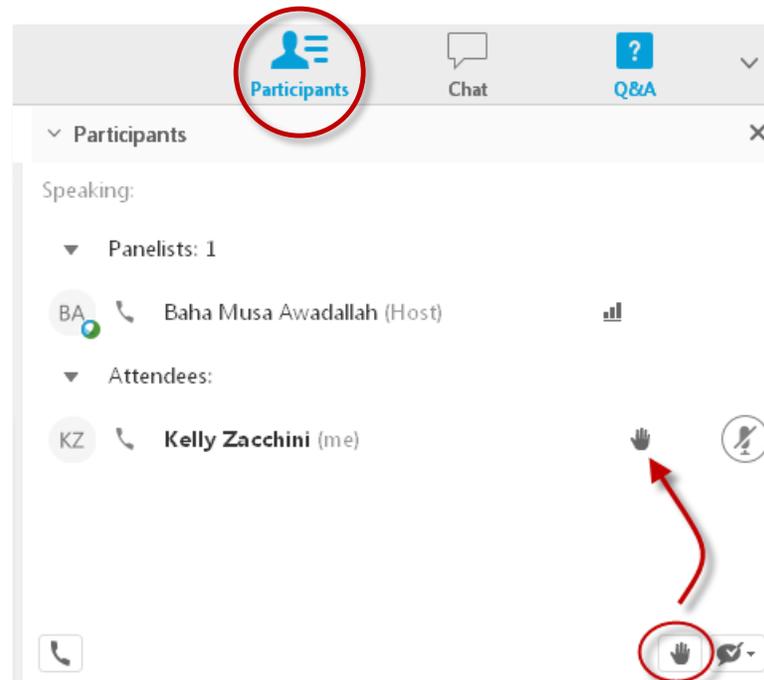
Can the Borrower use any rental income from the subject investment purchase to offset the full monthly payment on the subject property?

- A) Yes, only to offset the full monthly payment on the subject because they don't currently own any other rental properties
- B) No, the Borrower is not on the mortgage for their Primary Residence
- C) Yes, to offset the full monthly payment on the subject and any residual rental income can be added to gross income for the Borrower

In order to use rental income on a subject investment purchase:

- The Borrower must own a primary residence, or they cannot use any rental income on the subject investment purchase
- There's a limit as to how much rental income can be used to qualify, depending on whether the Borrower has a one year history of managing investment properties
- All of the requirements for rental income can be found in Guide Chapter 5306.1

To ask a question...
Raise your hand. Your line will be unmuted.



- Documentation requirements for certain income types
- Alimony



INCOME DOCUMENTATION REQUIREMENTS

In response to Seller feedback, we are updating the documentation requirements language for retirement income, survivor and dependent benefit income, long-term disability income and Social Security Supplemental Security Income to specify that one or more of the required documents (i.e., benefit verification letter, award letter, pay statement, 1099 and bank statement(s)) can be used to verify income type, source, payment frequency, payment amount and current receipt of the income. As a result, separate verification of current receipt of income is not required if the documentation obtained to support income type, source, payment frequency and predetermined payment amount also verifies current receipt of income.

5305.2



Specific requirements for other income types

Effective 04/03/2019



Bulletin 2019-7 Selling
04/03/2019

Documentation requirements for retirement income, long-term disability income, survivor and dependent benefit income and Social Security Supplemental Security income:

- ✓ Shows the type of income
- ✓ The source of income
- ✓ Pre-determined payment amount
- ✓ Frequency and current receipt



With this update, you should be able to meet all the requirements with less documentation by using one or more of the required documents (i.e. bank statement(s))

Alimony

- How we calculate income when a Borrower is required to pay alimony or separate maintenance



Alimony is an equalization of income, not a debt



Guide Section 5301.1(a)

General requirements for all stable monthly income

Effective Date 03/06/19

Refer to Bulletin 2019-006, which announced revisions related to requirements for alimony or maintenance payments. The revisions may be implemented prior to the mandatory implementation of the July 6, 2019 version of this section.



Monthly Income = \$10,000

Monthly Debt = \$3,000

Monthly Alimony = \$1,000

Old Way

Monthly Income = \$10,000

Monthly Debt = \$4,000

Monthly DTI = 40%

New Way

Monthly Income = \$10,000 - \$1,000 = \$9,000

Monthly Debt = \$3,000

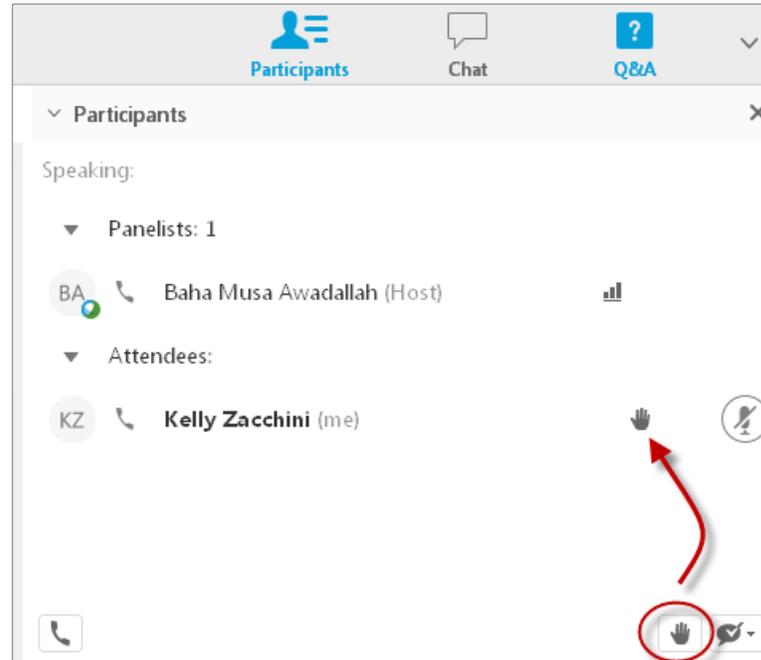
Monthly DTI = 33%



Other Income Related Topics

- May use bank statements to document retirement income, long term disability, survivor and dependent benefits and Social Security income, as long as certain requirements are met
- Alimony is treated as an equalization of income, not a debt

To ask a question...
Raise your hand. Your line will be unmuted.





The Freddie Mac
Learning Center

<http://www.freddiemac.com/learn/>



Customer Call Center –
Seller/Service Support

1-800-FREDDIE



Redesigned Single-Family

sf.FreddieMac.com

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Thank You
