Fannie Mae®

Selling Guide Announcement SEL-2018-09

December 04, 2018

Selling Guide Updates

The *Selling Guide* has been updated to include changes to the following:

- Calculating Self-employment Income
- Commission Income and Unreimbursed Business Expenses
- DU Version 10.3
- Appraisal Waiver Policy for Disasters
- On-Frame Modular and Modular Construction
- Small Business Administration Loans
- Kroll Rating Agency
- Flood Insurance
- Miscellaneous Updates

Each of the updates is described below. The affected topics for each policy change are listed on the Attachment. The *Selling Guide* provides full details of the policy changes. The updated topics are dated December 04, 2018.

In addition, we have updated the Uniform Underwriting and Transmittal Summary (Form 1008). We worked jointly with Freddie Mac to update this form. As a reminder, it is only required for manually underwritten loans. Lenders can begin using the updated form immediately, but must do so by July 1, 2019.

Calculating Self-employment Income

In response to lender feedback, we have updated the self-employment income calculation and evaluation policy. Our current policy allows lenders to use vendor tools to calculate self-employment income. These tools can be used to complete the cash flow analysis provided the tool applies the same principles as Fannie Mae's Cash Flow Analysis (Form 1084).

One such tool that lenders can use to calculate self-employment income is LoanBeam's FNMA SEI 1084 workbook. We have approved this tool and the calculations it performs. If lenders use it to calculate income and enter the monthly income amount in Desktop Underwriter® (DU®), we will provide representation and warranty enforcement relief on the accuracy of the calculation of the amount of self-employment income. The lender

- determines the eligibility of the self-employment income,
- must enter complete and accurate data in the vendor tool,
- cannot perform any manual overrides of the output results,
- accurately enters the calculated self-employment income amount in DU, and
- delivers the loan using Special Feature Code 777.

The Guide has been updated to reflect the use of approved vendor tools and the criteria that will result in enforcement relief. The list of Approved Vendor Tools is available on Fannie Mae's website. In addition, the Special Feature Codes list has been updated to include SFC 777.

Effective Date

Lenders may receive enforcement relief when using a Fannie Mae-approved vendor tool immediately.

Commission Income and Unreimbursed Business Expenses

We are removing the different treatment of commission income based on the percentage of employment income. Going forward all commission income will be treated the same, and individual tax returns (or tax transcripts) will no longer be required. We are updating our policy regarding commission income and unreimbursed business expenses due to recent changes made by the IRS that are effective with the reporting of 2018 federal income taxes.

Currently, unreimbursed employee expenses are reported as a deduction on the borrower's individual federal income tax return (IRS Form 2106, or IRS Form 1040, Schedule A or C). These expenses are used when calculating an automobile allowance and commission income when it is 25% or more of employment income.

As a result of the tax law changes that will prevent lenders from being able to identify unreimbursed business expenses, we are removing the requirements for IRS Form 2106, and changing the automobile allowance policy. The full amount of an automobile allowance may now be included as income and the lease or financing expenditure must be included as a debt in the calculation of the debt-to-income (DTI) ratio. (Note that a history of receipt of this income continues to be required.)

Effective Date

Lenders may implement these changes immediately and effective with the date of this announcement are no longer required to obtain tax return documentation or tax transcripts to identify unreimbursed business expenses.

The DU messages reflecting these changes will be updated in a future release. Until then, lenders may disregard the requirement to obtain IRS Form 1040 or Form 2106 for commission income and automobile allowance. Loan files that include qualifying income from an automobile allowance that is calculated following the "actual cash flow approach" must continue to include IRS Form 2106. This includes the practice of directly offsetting an automobile lease payment with an automobile allowance if the lease payment is captured as an expense on Form 2106.

Until the DU validation service is updated, lenders must continue to obtain a tax transcript for borrowers with commission income that is 25% or more of employment income to be eligible for income validation.

DU Version 10.3

The *Selling Guide* has been updated to reflect the changes that were announced in the DU/Desktop Originator® Version 10.3 Release Notes, including:

- risk factors evaluated by DU;
- new six month minimum reserve requirement for cash-out refinance transactions for borrowers with DTI ratios exceeding 45%;
- changes to how loans are underwritten if a borrower has a credit score, based only on medical tradelines; and
- appraisal waiver changes
    - messages for disaster impacted areas (see Appraisal Waiver Policy for Disasters above),
    - properties valued at $1,000,000 or more are not eligible for an appraisal waiver offer for refinances.

The DU resubmission tolerance that applies to data changes resulting in an increase to the DTI ratio has also been updated. Refer to the DU Version 10.3 Release Notes for additional information, including how the changes will impact DU Version 10.2 and 10.3 casefiles. In addition, the *Eligibility Matrix* has been updated to reflect "DU Version 10.3" and the reserve requirement for cash-out refinances.

Appraisal Waiver Policy for Disasters

Previously, lenders could not exercise an appraisal waiver offer on loans that were in process at the time of a disaster but were required to obtain an appraisal instead. With this update, we are adding the flexibility that lenders are now permitted to exercise appraisal waiver offers on loans in process at the time of a disaster. In order to use this flexibility, lenders must meet the same property eligibility requirements currently in place for loans already closed but not yet delivered when a disaster strikes:

- If the property was damaged and the damage does not affect the safety, soundness, or structural integrity of the property and the repair items are covered by insurance, the lender
  - may deliver the loan to Fannie Mae,
  - must obtain documentation of the professional estimates of the repair costs, and
  - ensure that sufficient funds are available for the borrower's benefit to guarantee the completion of the repairs.
- If the property was damaged and the damage is uninsured or the damage affects the safety, soundness, or structural integrity of the property, the property must be repaired before the loan is delivered to Fannie Mae.

DU will be updated the weekend of December 8, 2018 to include a new message that will be issued on loan casefiles for properties located in a disaster impacted area that received the appraisal waiver offer prior to the disaster. See DU Version 10.3 Release Notes for additional information.

Effective Date

Lenders can take advantage of this change for loan casefiles submitted or resubmitted on or after the weekend of December 8, 2018.

On-Frame Modular and Modular Construction

To better support affordable and rural housing supply, we are updating policies related to modular homes. On-frame modular homes that comply with local building codes, attached to a permanent foundation, and are built using the same materials as comparable stick-built homes are now an eligible property type. These homes will follow the same eligibility and underwriting criteria as stick-built homes. We are also clarifying that multi-unit buildings such as attached condos and townhomes may be built using modular construction techniques that comply with local building codes. No additional delivery data points are required as a result of these changes.

Effective Date

Lenders can take advantage of these changes immediately.

Small Business Administration Loans

We are clarifying that all Small Business Administration (SBA) loans secured by the subject property must be treated as subordinate financing and included in the calculation of the CLTV and HCLTV ratios. The monthly payment of the subordinate lien must also be included in the borrower's DTI ratio calculation unless the lender can satisfy the requirements in *Business Debt in Borrower's Name* in B3-6-05, Monthly Debt Obligations.

Effective Date

Lenders are encouraged to implement these clarifications immediately, and must implement them by March 2019. The related messaging in DU for loan casefiles with subordinate financing without a corresponding payment will be updated in a future release to reference the exception permitted for SBA loans.

Kroll Rating Agency

Policies related to property insurance carrier requirements for sellers and servicers have been consolidated into the *Selling Guide*. The following changes were made to our property insurance carrier ratings requirements:

- added Kroll Bond Rating Agency as an acceptable rating agency, and
- removed the more restrictive rating requirements for co-op projects; the general carrier rating requirements now apply.

Effective Date

Sellers/servicers can begin accepting property insurance with Kroll carrier ratings immediately.

Flood Insurance

In our continued efforts to simplify and consolidate policies shared by the *Selling* and *Servicing Guides,* duplicative policies related to flood insurance coverage requirements have been consolidated from the *Servicing Guide* B-3, Flood Insurance Requirements, into the *Selling Guide,* B7-3-07, Flood Insurance Coverage Requirements. In addition to the consolidation, the following clarifications have been made:

- High LTV refinance loans securing units in attached condo projects will be acceptable with individual flood insurance dwelling policies.
- Projects with over 25% commercial space that maintain a master flood insurance policy must obtain coverage, either through a single private policy or a private supplemental policy in conjunction with a General Property Form flood master policy through the National Flood Insurance Program (NFIP), to equate to coverage available to projects maintaining a Residential Condominium Building Association Policy.
- A flood insurance declarations page may not be used to verify that private insurance coverage is equivalent to NFIP coverage; the full policy must be reviewed.
- For flood insurance coverage for units in a project, the contents coverage for the building must be the lesser of 100% of the insurable value or the NFIP maximum available (not 100% of the insurable value).
- A mortgagee clause is not required for NFIP master policies or policies through a private insurer.

Additionally, two new policies were added providing further flexibilities for lenders;

- We removed the requirement for a condo homeowners' association to maintain a master flood insurance policy for two- to four-unit projects. Individual policies covering a single unit are now permitted.
- Loans in a community in the Emergency Program of the NFIP will no longer be required to maintain coverage to make up the difference between what is available through the Emergency Program and the Regular Program. Coverage available under the Emergency Program through the NFIP or a private policy with equivalent coverage will be acceptable until the community is approved to participate in the NFIP Regular Program.

We have also removed guidance related to the delivery of second liens that require flood insurance since we do not accept new deliveries of these loans. We updated references to Homestyle Renovation loans to extend to all renovation or construction mortgages.

Effective Date

Sellers are encouraged to implement these policy changes immediately; but must implement these changes by March 1, 2019.

Miscellaneous Updates

B2-3-01, General Property Eligibility: This topic has been updated to reaffirm that all mortgages sold to us must be secured by an interest in real property within the meaning of the Internal Revenue Code as such term is defined in 26 C.F.R. § 1.856-3.

B5-5.3-02, Loans with Resale Restrictions: Loan and Borrower Eligibility: In Announcement SEL-2018-05, we allowed more flexibility regarding the eligibility of manufactured homes with resale restrictions. This topic has been updated to align with that announcement. Manufactured homes with resale restrictions are now eligible when located in a PERS-approved project.

E-1-03, List of Contacts:

- **New Loan Quality Center Mailbox:** As of November 1, 2018, the Loan Quality Center Receipt and Assignment email address for alternate document submission methods has changed from lqc_fra@fanniemae.com to DDC_Inventory@fanniemae.com to reflect the new team name, Digital Data Control Team.
- **Fannie Mae Change of Address:** We have moved our corporate headquarters to the following:

  Fannie Mae
  Midtown Center
  1100 15th Street, NW
  Washington, DC 20005

We have updated this address in the List of Contacts in the Guide and on mortgage assignment forms 3741, 3742, 3743, 3744, 3745 and 3746. Lenders should begin using the new address immediately, and must discontinue using the old address by February 1, 2019.

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Lenders who have questions about this Announcement should contact their Fannie Mae Account Team.

Carlos T. Perez
Senior Vice President and
Chief Credit Officer for Single-Family

Attachment

Section of the Announcement	Updated *Selling Guide* Topics
Calculating Self-employment Income	▪ A2-2.1-04, Limited Waiver and Enforcement Relief of Representations and Warranties for Mortgages Submitted to DU ▪ B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower
Appraisal Waiver Policy for Disasters	▪ A2-2.1-06, Representations and Warranties on Property Value ▪ B2-3-05, Properties Affected by a Disaster ▪ B4-1.4-10, Appraisal Waivers
Treatment of Unreimbursed Business Expenses	▪ B3-2-02, DU Validation Service ▪ B3-3.1-01, General Income Information ▪ B3-3.1-04, Commission Income ▪ B3-3.1-06, Requirements and Uses of IRS Request for Transcript of Tax Return Form 4506-T ▪ B3-3.1-09, Other Sources of Income ▪ B3-3.3-03, DELETED TOPIC: Deductions Reported on IRS Form 2106 ▪ B3-3.5-01, Income and Employment Documentation for DU ▪ B3-6-05, Monthly Debt Obligations ▪ B5-5.2-02, DU Refi Plus and Refi Plus Underwriting Considerations ▪ B5-7-03, High LTV Refinance Alternative Qualification Path
Kroll Rating Agency	▪ B7-3-01, Property Insurance Requirements for Insurers
On-Frame Modular and Modular Construction	▪ B2-3-01, General Property Eligibility ▪ B2-3-02, Special Property Eligibility and Underwriting Considerations: Factory-Built Housing ▪ B5-2-01, Manufactured Housing
DU Release 10.3	▪ B2-1.2-03, Cash-Out Refinance Transactions ▪ B3-2-03, Risk Factors Evaluated by DU ▪ B3-2-10, Accuracy of DU Data, DU Tolerances, and Errors in the Credit Report

Section of the Announcement	Updated *Selling Guide* Topics
	▪ B3-5.1-01, General Requirements for Credit Scores ▪ B3-6-02, Debt-to-Income Ratios ▪ B4-1.4-10, Appraisal Waivers ▪ E-3-08, Glossary of Fannie Mae Terms: H
Flood Insurance	▪ B7-3-07, Flood Insurance Coverage Requirements ▪ B7-3-08, Mortgagee Clause for Property and Flood Insurance ▪ C1-2-02, Loan Data and Documentation Delivery Requirements
Small Business Administration Loans	▪ B2-1.1-02, Combined Loan-to-Value (CLTV) Ratios ▪ B2-1.1-04, Subordinate Financing ▪ B3-6-03, Monthly Housing Expense ▪ B3-6-05, Monthly Debt Obligations