Selling Guide Announcement SEL-2012-04

May 15, 2012

Selling Guide and Other Updates

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

- DU Refi Plus™ and Refi Plus™ updates
- Hardest Hit Funds℠ for DU Refi Plus and Refi Plus
- Employment and income policy changes
- Restructured mortgage loan policy

In addition, the following documents published on eFannieMae.com have been updated:

- *Eligibility Matrix*
- *eCommitONE User's Guide*
- *Standard ARM Plan Matrix*

Each of the updates is described below. The affected *Selling Guide* topics are identified below or in the Attachments to this Announcement. Lenders should review each topic to gain a full understanding of the policy changes. The updated topics are dated May 15, 2012.

> NOTE: *Due to the extent of the updates in the Selling Guide this month, lenders are reminded that Fannie Mae publishes a "highlighted" PDF version of the Selling Guide on eFannieMae.com (in addition to publishing by AllRegs®). This PDF identifies all of the changes that were made to the Selling Guide in this update, and is provided to lenders to help facilitate easy identification of the changes.*

DU Refi Plus and Refi Plus Updates

In an effort to attract more eligible borrowers who can benefit from refinancing their mortgage, Fannie Mae announced a number of enhancements to the Home Affordable Refinance Program (HARP) in November 2011. With this May *Selling Guide* update, Fannie Mae is further enhancing and clarifying many DU Refi Plus and Refi Plus requirements. A large number of the clarifications address questions Fannie Mae has received from lenders over the last few months.

Attachment 1 to this Announcement describes all of the updates and clarifications that are included in this Guide update. Key updates include:

- Allowing the simultaneous refinance of an existing subordinate lien;
- Allowing grant-like unsecured financing through a Housing Finance Agency (HFA) Hardest Hit Funds (HHF) program for the purpose of paying down the outstanding mortgage balance of the existing mortgage at the time of closing or for paying closing costs (see related section below);
- Allowing additional flexibility for removing borrowers from the loan;
- Removing the requirement for DU Refi Plus that required lenders to confirm fidelity insurance coverage for projects;

- Clarifying that existing mortgage loans that have been modified, or are in the process of being modified, are eligible for refinance under DU Refi Plus or Refi Plus;
- Clarifying underwriting requirements for Refi Plus mortgage loans that are identified as being higher-priced mortgage loans (HPML) in accordance with Regulation Z;
- Streamlining the documentation requirements for Refi Plus loans with payment changes equal to or less than 20%;
- Clarifying that the waiting period and re-establishment of credit requirements for significant derogatory credit events are not required for Refi Plus loans;
- Clarifying requirements for borrowers with multiple financed properties; and
- Clarifying the requirements for properties secured by leasehold estates.

Updated Selling Guide Topics

See Attachment 1 to this Announcement.

Effective Date

With the exception of the new policy allowing simultaneous refinance of subordinate financing, all of the updates and clarifications are effective immediately for both DU Refi Plus and Refi Plus. (See next section for information about DU Refi Plus and subordinate financing.)

Desktop Underwriter® (DU®) Implementation of Updates

DU will be updated in a future release to reflect the updated requirements. Until such time, lenders must apply the following to DU loan casefiles:

- Transactions that include the simultaneous refinance of an existing subordinate lien must be manually underwritten with Refi Plus.
- When a borrower is being removed with the DU Refi Plus transaction, lenders may disregard the message requiring a 12-month payment history or evidence of the previous borrower's death. However, the lender must confirm that the borrower(s) being removed from the loan is removed from the deed and retains no ownership interest in the property.

Hardest Hit Funds for DU Refi Plus and Refi Plus

The U.S. Department of the Treasury has awarded $7.6 billion in funding for innovative programs developed by state HFAs to stabilize local housing markets and prevent foreclosures in 18 states and the District of Columbia. The HHF programs provide funding for various purposes, including funds for principal curtailment, to help homeowners obtain more affordable mortgages or to help homeowners retain their homes.

HFAs have established programs utilizing HHF funds to support the HARP program. Each participating HFA establishes its own eligibility guidelines for borrower participation and approves the provision of HHF funds.

Loan Eligibility and Documentation Requirements

Fannie Mae is updating the eligibility and underwriting requirements for DU Refi Plus and Refi Plus to specifically permit grant-like unsecured financing provided to the borrower through an HFA HHF program for the purpose of paying down the outstanding mortgage balance at the time of closing resulting in a lower new loan amount. The HHFs may also be used for the payment of closing costs. The loan file must be documented with a copy of the promissory note or other documentation specifying the terms and conditions of the loan and include language indicating that repayment is not expected. The transfer of the loan proceeds must be reflected on the HUD-1 Settlement Statement. Lenders remain responsible for ensuring that all other DU Refi Plus and Refi Plus eligibility and underwriting requirements are met.

Effective Date

This policy is effective immediately for both DU Refi Plus and Refi Plus.

Employment and Income Policy Changes

Fannie Mae recently conducted a comprehensive review of employment and income policies. The review looked holistically at the current market and considered potential future risks, lender impact, requirements of other secondary market investors, DU requirements, and the current regulatory environment. As a result, Fannie Mae is making a number of changes to its income and employment policies.

Furthermore, Fannie Mae has taken the opportunity to clarify or restate a number of existing policies. A number of income and employment topics were also reorganized within Chapter B3-3, Income Assessment, of the *Selling Guide*.

> NOTE: *The comprehensive review that Fannie Mae completed did not include self-employment income or documentation policies. With a few minor exceptions, the updates and clarifications pertain to employment and other types of non-employment income, such as rental income, alimony, and interest and dividend income.*

General Income Verification Principles

Fannie Mae's employment and income policies focus on the borrower's ability to repay the mortgage debt and consider the stability, adequacy, and likelihood of continued receipt of income. For income to be used for qualifying purposes, the lender must be able to substantiate the income by documenting the source of the income, the amount of the income, and for certain types of income, the history of receipt and likelihood of continued receipt. The updates to income and employment policies were made with these core principles in mind.

Summary of Policy Changes

Attachment 2 to this Announcement identifies the major policy changes and clarifications that have been made in the Guide. The key updates include:

- New section describing variable income policies – how lenders should evaluate, document, and calculate income that fluctuates, such as hourly pay, overtime, bonus, and commission income. (The related topics link/refer back to this variable income section.)
- New section describing continuity of income policies – this section clearly differentiates the types of income that have a defined expiration date from those that generally do not expire. If the income does not have a defined expiration date, the lender may conclude that the income is stable, predictable, and likely to continue, and is not required to document continuance in the future. On the other hand, for income that does have a defined expiration date, the lender must document a three-year continuance. Fannie Mae has re-categorized long-term disability, interest and dividend income, and Social Security retirement income such that lenders no longer have to document a three-year continuance.
- The requirement for the borrower to sign an IRS Form 4506-T at both application and closing has been changed to only require signature once during the origination process. The timing is at the lender's discretion as long as it occurs on or before closing of the mortgage loan. This section was also updated to clarify alternatives to IRS Form 4506-T, including alternatives for borrowers with income from Puerto Rico.

- The verbal verification of employment (VOE) requirements were updated to include verifications performed by third-party vendors. In addition, lenders now have the alternative of obtaining the verbal VOE after closing, but prior to delivery of the loan to Fannie Mae. The name and title of the person who completed the verification for the employer must now be documented.
- A *Request for Verification of Employment* (Form 1005 or Form 1005(S)) was added to several sections as an alternative to the standard documentation requirements (paystub, IRS Form W-2).
- The documentation requirement for rental income for manually underwritten loans has been changed from two years tax returns to only one year of tax returns (when tax returns are required), and the *Operating Income Statement* (Form 216) is no longer required. Additional clarity has been provided regarding the use of lease agreements in lieu of tax returns when there is no prior history of receipt of the rental income, or if the tax return does not include a full year of rental income.

> NOTE: *These changes now align the documentation requirements for manually underwritten loans with DU loan casefiles.*

- Added new policies that allow employment offers or contracts – the lender may use the income from an employment offer or contract to qualify the borrower as long as the borrower begins employment (as evidenced by a paystub) prior to delivery of the loan to Fannie Mae.
- Reduced requirements for documenting prior receipt of the following income sources:
  - alimony and child support - 6 months (changed from 12 months),
  - public assistance income - not required (changed from 24 months).

> NOTE: *DU requires documentation of 3 months of receipt of alimony and child support. This requirement will be updated in a future release of DU to mirror the requirements for manually underwritten loans. (Lenders may continue to comply with the 3-month requirement until it is updated.)*

- The requirements for retirement income in the form of a distribution from a 401(k), IRA, or other retirement account have been clarified to now require that the borrower have unrestricted access to the accounts without penalty, and for stocks, bonds, and mutual funds the lender must factor in the potential for account volatility.
- A copy of the borrower's IRS Form W-4 is no longer required when documenting income from a mortgage credit certificate (MCC). MCC income may also be used for refinance transactions.

Updated Selling Guide Topics

See Attachment 2 to this Announcement.

Effective Date

These updates and clarifications provide additional flexibility, consistency, and efficiency in the processing of employment and income documentation. As such, the changes are effective immediately for manually underwritten loans. For DU loan casefiles, lenders are encouraged to implement the flexibilities immediately. For example, lenders may follow the new requirement for the IRS Form 4506-T and disregard the current DU message requiring the signing of this form at both application and closing. Lenders also have to option to continue to comply with the DU messages until such time as the messages are updated in a DU release that is planned for later this year.

Restructured Mortgage Loan Policy

A restructured loan is a mortgage loan in which the terms of the original transaction have been changed, resulting in absolute forgiveness of debt or a restructure of debt through either a modification of the original loan or origination of a new loan. Current Fannie Mae policy prohibits delivery of restructured mortgage loans. With this update, the *Selling Guide* is being clarified to reflect that the subsequent refinance of a restructured loan is eligible for delivery under certain circumstances. DU Refi Plus and Refi Plus transactions involving previously restructured loans are permitted without restriction.

Updated Selling Guide Topics

- B2-1.2-02, Limited Cash-Out Refinance Transactions (Ineligible Transactions)
- B2-1.4-02, Mortgage Loan Eligibility (Restructured Mortgage Loans)

Effective Date

This update is effective immediately.

Miscellaneous *Selling Guide* Updates

- B4-2.2-08, Project Eligibility Review Service (PERS) (Required Use of PERS): A change was made to the presentation of the policy regarding the types of projects that must be submitted through the PERS. No change was made to the policy.
- B3-5.3-09, DU Credit Report Analysis (Disputed Credit Report Tradelines): The *Selling Guide* has been update to clarify that if DU does not issue the disputed tradeline message on a loan casefile, no further action by the lender is necessary.

Effective Date

These updates are effective immediately.

Updated *Eligibility Matrix*

The *Eligibility Matrix* has been updated to reflect the following:

- DU LTV Ratio chart – DU Refi Plus was removed from the DU LTV ratio chart and incorporated into the Refi Plus LTV ratio chart. This latter chart now reflects the LTV ratios that are currently effective, including the updated limits that were implemented in the DU Version 8.3 March update release.
- Refi Plus chart:
  - The chart now includes DU Refi Plus requirements.
  - A footnote was updated to reflect that exceptions to the LTV ratio limits apply to Texas 50(a)(6) mortgages.
  - A footnote was updated to reflect the new policy regarding simultaneous refinancing of subordinate financing.
  - The footnote regarding credit scores was updated to remove the reference to “merged credit reports” (merged credit reports are not required for certain Refi Plus loans).
- The footnote on each chart that pertains to Community Seconds® was updated to reflect additional eligibility requirements that apply. (Existing policies that have not been specifically addressed in the *Eligibility Matrix*.)

Updated *eCommitONE User's Guide*

The *eCommitONE User's Guide* has been streamlined to reduce redundancy with other task-based job aids. This Guide can help lenders navigate the process of selling whole loans directly to Fannie Mae via a best efforts execution. For more information on best efforts program policies, refer to the *Selling Guide,* Section C2-1.2, Best Efforts Commitments to Sell Whole Loans.

Updated *Standard ARM Plan Matrix*

The *Standard ARM Plan Matrix* now differentiates that ARM Plan 2725 is available with two different lifetime interest rate caps – 5% and 6%:

- ARM Plan 2725 with 5% cap – mortgage loans are eligible for sale to Fannie Mae as whole loans or in MBS.
- ARM Plan 2725 with 6% cap – mortgage loans may only be sold in MBS; whole loan execution is not available.

> NOTE: *These are not new rate cap options. The Matrix was updated to highlight the existence of these two options.*

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

John Forlines
Vice President
Chief Credit Officer for Single-Family Product

Attachment 1

Updates to DU Refi Plus and Refi Plus

This table briefly describes the updates that have been made in the *Selling Guide* for DU Refi Plus and Refi Plus (in the order in which they appear in the Guide). Refer to the specific topics in the *Selling Guide* for additional details. In the event of any discrepancy between the information in this Attachment and the *Selling Guide,* the provisions in the *Selling Guide* will prevail.

Topic Number and Title (Block Name(s))	Description of Update – DU Refi Plus and Refi Plus
A3-2-02, Responsible Lending Practices (HPML Loans)	• Updated the example regarding Refi Plus loans to specifically apply to loans with payment changes less than or equal to 20%.
B2-1.1-04, Subordinate Financing B2-3-03, Co-op Properties	• Clarified that Fannie Mae will purchase or securitize co-op share loans with subordinate financing for DU Refi Plus and Refi Plus transactions. (Note: This is not a policy change – it is a long-standing policy that had not been specifically addressed in the *Selling Guide*.)
B2-1.4-02, Mortgage Loan Eligibility (Modified Mortgages)	• Added a reference to the applicable DU Refi Plus/Refi Plus topic regarding subsequent refinances of modified mortgage loans.
B2-2-03, Multiple Financed Properties for the Same Borrower (Loan and Borrower Requirements, Applying the Multiple Financed Property Policy to DU Loan Casefiles, Exception for DU Refi Plus and Refi Plus)	• Changed the manner in which the exception for DU Refi Plus and Refi Plus was stated, such that the exception now clearly applies to all of the multiple financed property requirements in the topic. That is, none of the multiple financed property requirements apply to DU Refi Plus or Refi Plus mortgage loans.
B3-5.3-07, Significant Derogatory Credit Events – Waiting Periods and Re-establishing Credit (General Information)	• Clarified that the requirements in this topic are not applicable to Refi Plus mortgage loans, but are applicable to DU Refi Plus loans.
Reorganization of Chapter B5	• The four DU Refi Plus and Refi Plus topics have been moved from Section B5-5.1 to their own Section B5-5.2, DU Refi Plus and Refi Plus Mortgage Loans. The remaining topics in Chapter B5 have been renumbered accordingly. (The topic numbers below reflect the new topic numbers.)
B5-5.2-01, DU Refi Plus and Refi Plus Eligibility (Loan Purpose; Maximum LTV, CLTV, and HCLTV Ratios and Eligible New Mortgage Loan Types; Eligible Subordinate Financing; Ineligible New Mortgage Loan Types; Borrower Eligibility)	• The subordinate financing requirements have been updated to allow the simultaneous refinance of an existing subordinate lien. The only requirement is that the new subordinate lien loan amount not exceed the existing unpaid principal balance of the subordinate lien. • Added provisions that permit the borrower to obtain grant-like unsecured financing through a Housing Finance Agency Hardest Hit Funds program for the purpose of paying down the outstanding mortgage balance of the existing mortgage at the time of closing or for paying closing costs. • Clarified that Fannie Mae will purchase or securitize co-op share loans with subordinate financing for DU Refi Plus and Refi Plus transactions. The lender must ensure that the subordinate lien is

Topic Number and Title (Block Name(s))	Description of Update – DU Refi Plus and Refi Plus
	subordinate to the new co-op share loan. • Updated the Maximum LTV, CLTV, and HCLTV Ratios table to reflect that DU Refi Plus now matches Refi Plus requirements (in accordance with the DU Version 8.3 March Update). • Added back language that temporary buydowns are not permitted on the new loan. (This policy was erroneously removed from the *Selling Guide* in the December 2011 update.) • Updated the Borrower Eligibility section of this topic to provide additional flexibility for removing borrowers from the mortgage loan.
B5-5.2-02, DU Refi Plus and Refi Plus Underwriting Considerations (Underwriting Requirements; Documentation Requirements; Multiple Financed Properties for the Same Borrower; Leasehold Estates Eligibility)	• The section of the topic "Seasoning Requirements – Short-Term Refinance Policy for Existing Mortgages" has been removed as it is no longer relevant. (This policy only applied to refinances within six months of the acquisition of the property.) • Added a policy that allows a borrower who has applied for or received a mortgage modification to be eligible to refinance under DU Refi Plus or Refi Plus. • Clarified that a Refi Plus loan with a payment change less than or equal to 20% that is identified as a higher-priced mortgage loan (HPML) in accordance with Regulation Z must comply with Regulation Z and the stricter underwriting requirements for Refi Plus loans with payment increases greater than 20%. • Clarified the mortgage payment history requirements for Refi Plus to reflect no "30-day" mortgage delinquencies in the most recent six-month period. • Added language to the Refi Plus underwriting requirements that specifically states that the waiting period and re-establishment of credit requirements for significant derogatory events are not required. In addition, the lender is not required to review or consider Declarations A through F in the *Uniform Residential Loan Application* as long as the credit score (if applicable) and mortgage payment history requirements are met. • Updated the requirements for Refi Plus loans with payment changes ≤ 20% to reflect: – all income sources must be eligible in accordance with the *Selling Guide*, – only one source of income for the mortgage loan must be verified, and – elimination of the requirement for a new merged credit report (credit scores are still required). • Currently the *Selling Guide* states that there are no limits on the number of financed properties the borrower may own. This update provides additional clarification that the eligibility requirements that pertain to borrowers with multiple financed properties are also not applicable to DU Refi Plus and Refi Plus

Topic Number and Title (Block Name(s))	Description of Update – DU Refi Plus and Refi Plus
	loans. • Added a new policy pertaining to Refi Plus mortgage loans secured by leasehold estates. (DU Refi Plus mortgage loans are subject to Fannie Mae's standard leasehold requirements.)
B5-5.2-03, DU Refi Plus and Refi Plus Property Valuations and Project Standards (DU Refi Plus Property Fieldwork Waiver; Condo, Co-op and PUD Project Review Requirements)	• Updated the DU Refi Plus Property Fieldwork Waiver section to reflect the contents of the *Desktop Originator/Desktop Underwriter Release Notes, DU Version 8.3 April Update* (return of the estimated property value). • Removed the requirement for the lender to confirm fidelity insurance coverage for condo, co-op, and PUD projects for DU Refi Plus loans.
B5-5.2-04, DU Refi Plus and Refi Plus Closing, Pricing, and Delivery (Escrow Account Requirements, Resubordination)	• Added a statement that lenders must comply with the standard provisions in the *Selling Guide* regarding escrow accounts. • Added an exclusion to the resubordination section for simultaneously refinanced subordinate liens.

Attachment 2

Updates to Employment and Income

This table briefly describes the updates that have been made in the *Selling Guide* for employment and income.

> NOTE: *The majority of the topics listed below underwent significant editing, including changes to policies, new guidelines that provide information to help lenders interpret and implement the policies, editing to provide clarity to existing policies, and removal of redundant or conflicting information. This table identifies the major changes and clarifications that were made; however, it does not identify all of the instances where content changed. Refer to the specific topics in the Selling Guide for additional details. In the event of any discrepancy between the information in this Attachment and the Selling Guide, the provisions in the Selling Guide will prevail.*

Topic Number and Title	Description of Update – Employment and Income
Part B, Subpart 3, Underwriting Borrowers, Introduction	• Added an introduction to the subpart that describes Fannie Mae's general underwriting policies.
Chapter B3-3, Income Assessment, Introduction	• Added an introduction to the chapter that describes Fannie Mae's general income assessment policies.
Reorganization of Chapter B3-3	• The four topics that were previously in Chapter B3-3, Section B3-3.1 were moved to other locations in the Chapter: – Requirements and Uses of IRS Form 4506-T moved to B3-3.1-06 – Verbal Verification of Employment moved to B3-3.1-07 – Verification of Income for Non-U.S. Citizen Borrowers moved into topic B3-3.1-01 – Using Nontaxable Income to Adjust the Borrower's Gross Income moved into topic B3-3.1-01 • Section B3-3.1 was renamed "Employment and Other Sources of Income." • All remaining sections (and topics) in the Chapter were renumbered accordingly. • The content in the topics in Section B3-3.1 was reorganized for better flow. General information and policies that apply to multiple topics were combined into two topics, reducing redundancy. Applicable links to these general topics were added throughout the Chapter.
B3-3.1-01, General Income Information (formerly Salary and Commission Income)	• This topic now includes general policies that apply to various sources of income. • Added guidelines regarding evaluation of variable income (e.g., hourly pay, overtime, bonus, commission) including history of receipt, frequency of payment, and income trending. • Revised continuity of income requirements including specific identification of the types of income that do/do not require the lender to document a three-year continuance. • Regarding income sources with a defined expiration date or those that are based on depletion of an asset – added guidance that lenders should consider the borrower's continued ability to repay the loan when the income source expires or the asset is depleted.

Topic Number and Title	Description of Update – Employment and Income
B3-3.1-01, General Income Information (formerly Salary and Commission Income) (con't)	• Clarified the criteria that identify when the lender must obtain copies of federal income tax returns to verify income – income from temporary or periodic employment (or unemployment); – borrowers receiving interest and dividend income; – income from sole proprietorships, limited liability companies, or any other type of business structure in which borrower has a 25% or greater ownership interest; and – borrowers claiming unreimbursed business expenses was removed from the list. • As previously noted, the following sections of the topic were moved from another part of the Chapter – Non-U.S. Citizen Borrowers, and – Using Nontaxable Income to Adjust the Borrower's Gross Income. • Clarified that the income documentation requirements in Chapter B3-3 are not applicable to DU Refi Plus of Refi Plus mortgage loans.
B3-3.1-02, Standards for Employment Documentation (formerly Verification of Salary and Commission Income)	• This topic has been broadened to describe the standards for all employment documentation (not just documentation for salary and commission income). • The table describing documentation provided by the borrower was reorganized to distinguish the requirements for paystubs and W-2s from those that apply to tax returns.
B3-3.1-03, Base Pay (Salary or Hourly), Bonus, and Overtime Income (formerly Bonus and Overtime Income)	• The verification requirements for base pay, bonus, and overtime income were combined into this topic (previously this information was presented in separate topics). • Added the Form 1005 (Form 1005(S)) as an alternative to the standard documentation requirements. • Added basic income calculation guidelines. • As previously noted, Military Income requirements were moved into this topic.
B3-3.1-04, Commission Income	• Clearly differentiated the documentation requirements for commission income based on the percentage of commission income to total employment income (changed from total "annual" income).
B3-3.1-05, Secondary Employment Income (Second Job and Multiple Jobs) and Seasonal Income (formerly Part-Time, Second-Job, Multiple-Job, and Seasonal Income)	• More clearly defined secondary employment income as coming from a second job or multiple jobs, without regard to whether the job is "part-time." (This update removes the confusion that previously existed when a borrower's sole job was a part-time job. Lenders questioned which documentation policies were applicable – base pay or part-time income.) • Removed the requirement for lenders to verify that second or multiple jobs have a strong likelihood of continuance.
B3-3.1-06, Requirements and Uses of IRS Form 4506-T	• As previously noted, this topic was moved to its current location in the Chapter. • Changed the requirement for each borrower to sign a separate IRS Form 4506-T to only once during the origination process (no longer required at both application and at closing). The lender can determine when the form should be signed as long as it occurs on

Topic Number and Title	Description of Update – Employment and Income
	or before closing. • Alternatives to this Form now include IRS Form 4506T-EZ. • Borrowers with income from Puerto Rico must use Modelo SC 2907(Solicitud De Copia De Planilla, Relevo De Herencia Y De Donacion).
B3-3.1-07, Verbal Verification of Employment	• As previously noted, this topic was moved to its current location in the Chapter. • If the verbal VOE is not performed before closing (or an update is required), it can be performed after closing, but prior to delivery to Fannie Mae. • The name and title of the person who completed the verification for the employer must be documented (in addition to the name and title of the person who completed the verification for the lender). • Exceptions to the verbal VOE requirement are described and include use of a third-party employment verification vendor. Information in the vendor's database may be no more than 35 days old as of note date. • For military personnel, in lieu of a verbal VOE or additional Leave and Earnings Statement, verification through the online Defense Manpower Data Center is permitted.
B3-3.1-08, Rental Income	• Clarified there are no restrictions on the type of property if the rental income is derived from a property that is not the subject property. For example, commercial properties are an acceptable source of rental income in this instance. • Additional clarity has been provided regarding the use of lease agreements in lieu of tax returns when there is no prior history of receipt of the rental income, or if the tax return does not include a full year of rental income. • Documentation requirement for rental income has been changed from two years of tax returns to only one year of tax returns (when tax returns are required). • Removed the requirement for the *Operating Income Statement* (Form 216). • Added a reference to an existing policy in the *Selling Guide* that requires the lender to verify that a lease transferred to the borrower does not contain any provisions that could affect Fannie Mae's first lien position on the subject property. • Provided guidance for calculating rental income when there is partial or no rental history on tax returns.
B3-3.1-09, Other Sources of Income	• Alimony or Child Support – the payment history requirement has been reduced from 12 months to 6 months (for manually underwritten loans). Receipt of this income for less than 6 months can no longer justify higher qualifying ratios. • Automobile Allowance - receipt of this income for less than two years can no longer justify higher qualifying ratios. • Disability Income (long-term) – clarified that the policy applies to long-term disability other than disability income received from the Social Security Administration, and if the income requires re-evaluation of benefit eligibility, it is not considered to have a defined expiration date.

Topic Number and Title	Description of Update – Employment and Income
B3-3.1-09, Other Sources of Income (con't)	• Employment Offers or Contracts – Added new policies that allow income from an employment offer or contract if certain requirements are met. • Employment-Related Assets as Qualifying Income - clarified that for all employment-related assets that are in the form of stocks, bonds, and mutual funds, the lender must factor in the potential for account volatility when calculating the income stream. • Foreign Income – broadened the definition of foreign income to include any borrower who is employed by a foreign corporation or government (previously defined as only applying to U.S. citizens). • Foster-Care Income – removed the requirement to verify that the borrower is likely to continue to provide this service at the current level. • Interest and Dividend Income – removed the requirement to verify that the borrower will receive the income for at least three years. • Mortgage Credit Certificates – removed the requirement for the lender to obtain a copy of the borrower's IRS Form W-4, and clarified that MCCs are acceptable on refinance transactions. • Non-Occupying Co-Borrower Income – clarified that the 90% LTV ratio limitation for manually underwritten loans and 97% limit for DU loan casefiles also apply to the CLTV and HCLTV ratios, accordingly. • Notes Receivable Income – clarified that payments on notes executed within the last 12 months may not be used to qualify the borrower. • Public Assistance Income - removed requirement to document a two-year history of income. • Retirement, Government Annuity, and Pension Income – clarified that when the retirement income is paid as a monthly distribution from a 401(k), IRA, SEP, or Keogh account that the borrower must have unrestricted access to the accounts without penalty. If the assets are stocks, bonds, or mutual funds, the lender must factor in the potential for account volatility when calculating the income stream. • Social Security Income – clarified that Social Security income for retirement or long-term disability does not have a defined expiration date and must be expected to continue. Corrected the documentation requirement to reflect a Social Security Benefit Statement (Form SSA-1099) (in lieu of an IRS W-2). • Tip Income – the requirements were reformatted to be more consistent with the other income types. Removed the requirement for the employer to verify the likelihood of continued receipt. • Trust Income – removed the misplaced reference to trust account distributions used as an asset.
B3-3.2.1-02, Income Reported on IRS Form 1040	• Alimony Received – removed the (duplicative) requirements for verifying alimony and replaced the text with a link to B3-3.1-09, Other Sources of Income. • IRA Distributions, Pensions and Annuities, and Social Security Benefits – removed the reference to three-year continuance and replaced the text with a link to B3-3.1-09, Other Sources of Income.

Topic Number and Title	Description of Update – Employment and Income
	• Unemployment Compensation – removed the reference to documenting a two-year history of receipt and replaced the text with a link to B3-3.1-09, Other Sources of Income. • Other Income (of Loss) – removed the reference to three-year continuance and replaced the text with a link to B3-3.1-09, Other Sources of Income.
B3-3.3-01, Documents Used for DU Income Assessment	• Removed references to calculation of monthly income. • Updated the references to other applicable topics.
B3-3.3-02, Income and Employment Documentation for DU	• Updated this topic in accordance with changes made to other related topics (as described above). NOTE: *DU still allows less documentation for verifying base pay (one paystub, or one paystub and previous W-2).*
B3-3.3-03, Income from Rental Property	• Previously, this topic identified a number of documentation differences between loan casefiles underwritten with DU and manually underwritten loans. Those differences have been removed based on the changes to manually underwritten loans described in B3-3.1-08, Rental Income. (Documentation requirements for manually underwritten loans now match DU loan casefiles.)

IRS Form 4506-T Lender Tips

May 2012

This document provides tips for lenders regarding use of the *Request for Transcript of Tax Return* (IRS Form 4506-T), including what information is available, what to request from the IRS, and how to review the results.

Use of the IRS Form 4506-T

Fannie Mae's policy regarding use of the IRS Form 4506-T to validate borrower income documentation requires the lender to

- have each borrower (regardless of income source) complete and sign a separate Form 4506-T at or before closing, and
- add the execution of IRS Form 4506-T with the IRS (directly or through an authorized vendor) to their written quality control (QC) plan. (Refer to the *Selling Guide*, Subpart D1, Lender QC Process, for details about lender QC requirements.)

Although Fannie Mae strongly encourages lenders to consider prefunding reviews in their QC plans, it is not mandatory. However, all loans selected for post-closing QC reviews, regardless of the sampling method, must include the execution and validation of the IRS Form 4506-T results. (See Reviewing the Results below for additional information.) Given that IRS Form 4506-T is valid for only 120 days after completion (including signature) by the borrower, the lenders should take that into consideration when deciding at what time in the process borrower completion of the Form will be the most beneficial.

NOTE: *Lenders that obtain the appropriate IRS transcripts during their pre-closing process (processing and underwriting) may use the same documents in their QC process without ordering new transcripts. In addition, the actual transcripts are an acceptable replacement of the signed IRS Form 4506-T(s) in the loan file.*

What Is Available

Use of IRS Form 4506-T has become the most efficient method for lenders to obtain a borrower's income tax information – the information is available electronically and quickly. In response to submission of a IRS Form 4506-T, the IRS provides a line-by-line transcript of the information it has received for up to the past four tax years. Transcripts available through submission of IRS Form 4506-T include the following series:

- **1040:** U.S. Individual Income Tax Return
- **1065:** U.S. Return of Partnership Income
- **W-2:** Wage & Tax Statement
- **1098:** Mortgage Interest/Student Loan Interest/Tuition Statements
- **1099:** Dividends/Interest, Miscellaneous Income, Government Payments, Cancellation of Debt, etc.

- **1120:** U.S. Corporation Income Tax Return
- **5498:** IRA, HAS, Archer MSA, Medicare Advantage ASA, Coverdell ESA Contributions

NOTE: *Request for Copy of Tax Return (IRS Form 4506) and Tax Information Authorization (IRS Form 8821) are also acceptable; however at this time, the tax information available using these forms is not available electronically. In addition, the eligible timeframes for the forms differ – Forms 4506-T and 4506 are valid for 120 days after completion, but Form 8821 is valid for only 60 days after completion.*

What to Request from the IRS

The table below shows the documentation that should be requested when using IRS Form 4506-T. The requested documentation should follow Fannie Mae's income documentation requirements, which depend on the type of borrower income (self-employed, salaried, commissioned, etc.) and the underwriting method (Desktop Underwriter® [DU®] or manual).

If Standard/DU Income Documentation Option Is … **(as determined by the *Selling Guide* or the DU Recommendation)**	**The 4506-T request must include most recent filing of …**			
	1040 *(4506T-EZ may also be used)*	**1120 or 1065**	**1099**	**W-2**
YTD Paystub				1 year
YTD Paystub and One W-2				1 year
YTD Paystub and Two W-2s				2 years
YTD Income Information and One 1099/1040	1 year		1 year	
YTD Income Information and Two 1099s/1040s	2 years		2 years	
One Year Personal Returns	1 year			
Two Years Personal Returns	2 years			
Two Years Personal Returns and Two Years Business Returns	2 years	2 years		

Examples

- When **manually underwriting a salaried borrower**, the lender should request two years of W-2s*.
  - January 2012 initial request to the IRS: 2009 and 2010 W-2s.
- When **underwriting a salaried borrower through DU**, DU may only require a recent paystub. In this case, the lender should request the most recent available W-2*.
  - June 2012 initial request to the IRS: 2011 W-2.
- When **manually underwriting a self-employed borrower**, the lender should request two years of individual federal tax returns. In this case, the lender should request the most recent two years of available tax returns*.
  - January 2012 request to the IRS: 2009 and 2010 Form 1040s.

- August 2012 request to the IRS: 2009 and 2010 Form 1040s.

NOTE: ** When requesting this information, lenders must take into consideration the documentation delays. It typically takes the IRS 6 to 8 weeks to add new filings or corrections to its database.*

Reviewing the Results

The execution of the IRS Form 4506-T with the IRS can be a tool to document borrower income, but the intent of this policy is to use the Form to validate the income documentation provided by the borrower and used in the underwriting process.

If the documentation used to calculate the borrower's income (e.g., 2011 W-2 for Borrower 1 from Employer A) is the same year as the information available from the IRS (e.g., 2011 W-2 transcript for Borrower 1 from Employer A), the information must match exactly (differences for rounding purposes are acceptable).

There are some instances, however, in which a variation between the income documentation and the IRS transcript is acceptable. For example, if the income documentation requirement is one year-to-date paystub, there is a likelihood of variation between the paystub and the W-2 transcript from the IRS (because of the typical 6- to 8-week lag in IRS database updates).

The following questions may assist in determining whether the differences between the income documentation and IRS transcripts are reasonable or if additional documentation is needed:

- ❑ Did the borrower file a joint return but is on the loan application alone?
- ❑ Did the borrower change jobs? Is he/she in the same line of work but with a different company?
- ❑ Did the borrower receive a promotion?
- ❑ Did the borrower's compensation structure change (e.g., from base to commission or from salary to hourly)?
- ❑ In the previous year(s), did the borrower receive bonus or overtime compensation that is no longer offered?
- ❑ Is the borrower now receiving bonus or overtime compensation that was not offered previously?
- ❑ Did the borrower not have enough income to require the filing of a federal tax return (e.g., single filer with income < $8,950)?
- ❑ Is there undisclosed self-employment loss for a co-borrower or non-borrowing spouse?

The lender must review the transcript information to determine the reasons for any income discrepancies (e.g., borrower provided his/her 2011 W-2, but the IRS only had 2010 W-2 transcript information available). If the discrepancies cannot be explained by information already in the loan file, the lender must obtain additional information to satisfactorily address any and all inconsistencies.