Fannie Mae

Best practices for rental income verifications

Lender responsibility to resolve discrepancies

Prudent origination, processing, and underwriting practices on all loans should include looking for conflicting and contradictory information in the loan documents that raise questions about the transaction and working to resolve them when identified.

> When discrepancies are identified, lenders must conduct additional due diligence to determine the validity of the information.

This document describes common red flags related to falsified rental income derived from the lease agreement for the departure property that is needed to qualify the borrower. The rental income is needed to show sufficient income or offset the mortgage payment on the departure property. In cases where the borrower has debt-to-income (DTI) ratio sensitivities, verifiable rental income is often the determining factor in qualifying.

If red flags indicate discrepancies, then Lender due diligence is required to investigate and resolve. Fannie Mae does not prescribe specific methods to investigate red flags, but the suggestions in this document are common best practices in the industry. Rental income documentation may reveal one or more discrepancies, and while each borrower scenario is unique, the information should be viewed holistically.

Rental income – common red flag characteristics

- Public records don't show the departure property was listed for rent.
- Interested party (i.e., lender, broker, real estate agent) sent the lease to alleged tenant or maintains an interest in managing the departure property.
- Lease is electronically signed without other supporting evidence, such as rental listing, receipt showing email sent to alleged tenant, or inability to provide copies of security deposit, rental payments, or rental receipts.
- Borrower will be a first-time landlord in leasing the departure property.
- Rental payment amounts appear inflated compared to market rental rates.
- Monthly rental payments used to offset the PITIA for the departure property.
- Alleged tenant has a pre-existing relationship with the borrower (i.e., same employer, nearby neighbor) or is a relative (non-borrowing spouse, parent, sibling, other).
- Alleged tenant already occupies or owns the departure property prior to the lease date.
- Alleged tenant already owns real estate that they presently occupy.
- Alleged tenant is a gift donor to the borrower.
- Bank statements show alleged tenant is paying both rental and mortgage on departure property.

- Leases provided for multiple rental properties that disclose the same alleged tenant for each lease.
- Rent payment amounts appear to be altered on lease agreement.
- Inability to validate lease terms with the alleged tenant.
- Effective date or occupancy date of the lease agreement is unreasonable when compared to the lease execution date or anticipated closing date of the subject property.
- Excessive Desktop Underwriter® (DU®) submissions with rental income added or adjusted until Approve / Eligible was obtained.
- Supporting documents for first two rental payments show deposits on the same day or payment by money order.
- Departure property has significant equity, yet source of funds for new purchase money loan is a substantial gift.
- Lender has previously financed mortgage loans for borrower, then sees unreconciled discrepancies on new loan application (occupancy misrepresentation, flags for terms not fulfilled, extenuating circumstances not met).
- Credit reports reflect mortgage loan on a recently acquired property was sold to a GSE; loan terms suggest borrower is obligated to maintain occupancy for 12 months, which means borrower is ineligible for a new primary residence for a period per Guidelines (rate, LTV, MI, withdrawals for down payment, etc.)

What lender due diligence looks like

- Use publicly available information (i.e., Zillow/Redfin/Realtor.com/Trulia) to assess the departure property status:
  - Is the departure property listed for sale before the Note date of the subject property?
  - Does the monthly rental amount appear reasonable for the size/style of home or other nearby rental listings?
- Do all the relevant dates line up or are some dates illogical?
  - Compare the departure property listing date, lease date, occupancy date, closing date, and Note date.
  - Did the sales contract for the subject property include a "contingency clause" for sale of the departure property which was removed prior to closing?
  - Does occupancy date on the lease for the departure property give the borrower time to move out after closing?
- Look at other information in the loan file to see if the transaction makes sense:
  - Do bank statements show security deposit checks and rental payment checks were deposited?
  - Do amounts and dates on the bank statements align with amounts and dates on the lease agreement?
  - Reconcile dates and amounts bank statements, check copies, or receipts to help identify "fake" or altered documents.
- Look for possible pre-existing relationships with the alleged tenant.
  - Does the alleged tenant appear to be an interested party to the transaction or a relative, co-worker or neighbor?
- Obtain a copy of the Property Insurance policy on the departure property and see if it supports tenant occupancy.
  - Has the policy been converted to a landlord policy, or does it include rental or tenant coverage?
  - Is the mailing address of the insured (the landlord) different than the departure property?

What lenders can do everyday

Create a culture of quality by taking steps to detect and prevent problems in your loan manufacturing process.

- Know your third-party originators/brokers by ensuring they are properly vetted during your approval process.
- Use industry fraud tools.
- Utilize owner occupancy affidavits, where applicable.
- Perform targeted quality control (QC) selections on transactions with "red flag" characteristics, including reverification of lease agreements, continuation of rental payments, or looking to see if the departure property gets listed for sale after closing.
- Target loans with unresolved red flags as of the closing date for post-closing occupancy validation.
- Track your reverification responses – lack of response for a particular loan officer, branch, or regional office may indicate that closer scrutiny is warranted.
- Learn about common red flags involving rental income and monitor evolving trends.
    - Update requirements for supporting documentation to verify information (i.e., canceled checks, fully executed lease agreements, capture screen shots of information on publicly available sites)
- Train your staff and share information with them regularly, favoring written guides to promote consistency and reducing reliance on experience or memory.
- If the loan doesn't make sense, don't do it!
- If you see something – say something. Issues identified need to be self-reported to Fannie Mae as required by the *Selling Guide* **D1-3-06, Lender Post-Closing Quality Control Reporting, Record Retention, and Audit | Fannie Mae**.

Examples of potential discrepancies with rental income

Example 1

1

Transaction characteristics:

- Borrower is purchasing a new primary residence and retaining departure property.
- Departure property is listed for rent, and occupancy date in rental agreement is soon after the Note date.
- Borrower will not qualify without rental income.
- Borrower is first time landlord.

Lease agreement and loan terms:

- Alleged tenant is also a gift donor.
- Rental payment amounts appear to be altered (increased) on lease agreement.
- Lease signature date and lease terms are inconsistent with closing date for the subject property, such as much too early or the same date as closing.

Asset documentation:

- Bank statements disclosed rental payment deposits that correspond to checks written by the borrower's non-obligated spouse, on a different account shared by the spouses (and disclosed on account statements in the loan file).
- Shared bank account statements also disclosed the mortgage payment deduction for the departure property.

In this scenario, discrepancies on the lease agreement and discovery of the family relationship between the alleged tenant and the borrower indicated several red flags that warranted further research.

Additional due diligence revealed:

- The borrower committed occupancy fraud to get a lower interest rate on the purchase money mortgage loan for the subject property, stating an intent to occupy the subject and rent the departure property.
- The borrower never planned to occupy the subject property.
- The subject property was purchased as an investment property.
- The borrower fabricated a lease agreement for the departure property.
- The borrower needed rental income from the departure property to qualify for the loan on the subject property.
- The non-borrower spouse was the alleged tenant on the lease agreement.
- The tenant (non-borrower spouse) provided gift funds.
- The alleged tenant (non-borrower spouse) was already responsible for the mortgage payment on the departure property.
- Spouses weren't separating or divorcing.

Example 2

Transaction characteristics:

- Borrower is purchasing a new primary residence and retaining departure property.
- Borrower is downsizing from a larger and more expensive home to a notably smaller and much less expensive house.
- Departure property was listed for rent, and lease start date is soon after subject Note date.
- Subject property has significant or unrealistic commuting distance from borrower's workplace and type of employment is inconsistent with the commuting distance (e.g., Borrower is a security guard and can't work from home).
- Borrower will not qualify without rental income.

Lease agreement and loan terms:

- Fabricated lease looked legitimate.
- Security deposit amount listed on fabricated lease did not match the amount listed on the copy of the check provided by borrower (not cancelled).

Asset documentation:

- No record of security deposit amounts located on borrower's bank statements.

In this scenario, the security deposit discrepancy and downsizing to a property far away from the borrower's workplace indicated red flags that warranted further research.

Additional due diligence revealed:

- The borrower committed occupancy fraud to get lower interest rates on the mortgage loan to buy the investment property.
- The borrower fraudulently stated an intent to occupy the subject and rent the departure property.
- The borrower fabricated the lease agreement for the departure property.
- The borrower purchased the property as an investment property and never planned to occupy the subject property.
- The borrower needed rental income from the departure property to qualify for the subject loan.

Example 3

3

Transaction characteristics:

- Borrower is purchasing a new primary residence and retaining departure property.
- Departure property is listed for rent, and lease start date is soon after subject Note date.
- Borrower will not qualify without rental income.
- Borrower is first time landlord.

Lease agreement and loan terms:

- Lease agreement contained a date discrepancy - the lease termination date was earlier than the lease start date.

In this scenario, the date discrepancy indicated an obvious red flag that warranted further research.

Additional due diligence revealed:

- A search using common public real estate listing sites (i.e., Zillow/Redfin/Realtor.com/Trulia) revealed the departure property was listed for sale around the same timeframe as the start date for the lease.
- The departure property was listed and sold prior to Note date for the subject property.
- The borrower fraudulently stated an intent to rent the departure property, when they planned to sell it.
- The borrower fabricated the lease agreement for the departure property.
- The borrower used fake rental income from the departure property to qualify for the subject loan.
- The borrower did not qualify without the rental income, making the loan ineligible for sale to Fannie Mae.

Example 4

4

Transaction characteristics:

- Borrower is purchasing a new primary residence and retaining departure property.
- Departure property was listed for rent, and lease start date is soon after subject Note date.
- Borrower will not qualify without rental income.

Lease agreement and loan terms:

- Rental payment amounts appear to be altered (increased) on lease agreement.

Asset documentation:

- Security deposit and first month's rental amount on current bank statements do not align with amount listed on lease agreement.

In this scenario, the date discrepancy indicated an obvious red flag that warranted further research.

Additional due diligence revealed:

- A recent MLS listing for the departure property disclosed its bedroom count which revealed that a typical rental listing in that zip code for that bedroom count rented for well below the alleged rent amount.
- A search using common real estate listing sites (i.e., Zillow/Redfin/Realtor.com/Trulia) revealed the departure property as listed for rent below the alleged monthly lease amount around the same timeframe as the start date for the lease.
- The borrower altered the departure property lease agreement by inflating the rent payment.
- The borrower falsified higher rental income from the departure property than what they were actually getting, to qualify for the loan on the subject property.

Additional resources

Beyond the Guide: See especially "Managing Fraud Risks" (pgs 4–5)

Lender self-reporting: *Selling Guide* **D1-3-06, Lender Post Closing Quality Control Reporting, Record Retention, and Audit**