**General Income Statement - Verification Requirements**

**Policy**

Verification of qualifying income sources, amounts, taxable status, seasoning and probable continuance are required critical components in the determination of credit worthiness.

To assess the likelihood of continuity and stability, the greatest weight is given to historical experience that can be verified to the satisfaction of Underwriting.

All sources of income included in the loan qualification must be stable, with a reasonable expectation that at least the same level of income will continue to be received for a minimum of three (3) years. Income may not be used for qualification when there is any knowledge or documentation indicating that it will terminate within the next three (3) years.

**Notes**:

* Obtain tax returns from self-employed borrowers regardless of whether the income is being used to qualify. This determines if there is a business loss that may have an impact on the stable monthly income used for qualifying.
* Specific product or program income verification requirements may differ. Please refer to product guidelines in the Lending Book for clarification.

**Variable Income**

**Notes: Lending Direct - Mortgage Only**

Some sources of income are considered to be variable.  Analyze these types of income sources with additional care as they are subject to external influences that may be beyond the borrower's control.

* When used in qualifying income, variable sources must be reported separately when possible. This is especially important with commissions and bonuses.
* Underwriting has the authority to determine whether a VOE is required to calculate variable sources of income.
* Sufficient pay stubs or statements must be obtained to validate the monthly or annual income calculation. Typically two consecutive pay stubs are required although one pay stub may be allowed, subject to AUS requirements, if dated no earlier than 30 days from application date and a minimum of 30 days year-to-date earnings is documented.
* Use an average of the past two years' income for sources that are variable, but verified to be consistent and stable.
  + When Underwriting feels justified in utilizing a probable amount other than the average, either higher or lower, document those considerations and include in the file any supporting documentation provided.
* Tax returns may be required.
* Significant increases in income should be adequately explained.
* Declining income sources must be carefully analyzed should not be averaged, and an explanation for the decline should be obtained. Use the most recent lower income for qualification purposes or the income source may be determined to be ineligible for qualification purposes.
* When knowledge exists of negative market conditions that would suggest the income source is not sustainable, do not use it to qualify the borrower.

**Income Verification Requirements**

Verification is required for each applicant on all applications. Acceptable verification is written proof of the income stated by the applicant. Please refer to product guidelines in the Lending Book.

Use of the term "qualify" in this policy indicates that the debt-to-income (DTI) requirement is satisfied. Income that cannot be verified is removed from the credit processing system and therefore excluded from the applicant’s qualifying income.

**Notes**:

* Individual applicants providing a joint tax return for verification of unearned income (i.e., rental, interest and dividend) must provide evidence of asset ownership to use the income in qualification.
* **Lending Direct - Mortgage Only**: Documentation requirements may vary according to Automated Underwriting System (AUS) findings. AUS requirements supersede credit policy.

**Acceptable Income Sources**

Consider income from the sources outlined below in reviewing applications for qualification. Generally, the income must be stable with a reasonable expectation that it will recur for the lesser of the loan term or three years. In addition, declining income sources must not be averaged. Instead, the most recent, lower, income amount must be used for qualification purposes, including a documented explanation for the decrease.

**Note**: When knowledge exists of negative market conditions that would suggest the income source is not sustainable, do not use it to qualify the borrower.

**Grossing-Up Income**

Income is grossed-up when either or both of the following conditions exist:

* The customer provides a net amount for their wage income.
* The customer provides an income figure from a non-taxable source identified in the net column below.

**Lending Direct - Mortgage**

Gross up newly received sources of income only when the income source has been determined, via verifiable documentation, to be non taxable in all instances. See Other Income to make that determination.

**Lending Direct - Home Equity**

Refer to the table below to determine when a source of income can be grossed-up. Use the factor 1.25 to gross-up acceptable sources.

To gross-up income, a copy of the most recent tax return is required to evidence the non-taxable status.

|  |  |  |
| --- | --- | --- |
| **INCOME SOURCE** | **Gross** | **Net** |
| 401K Distributions | X |  |
| Aid to Dependent Children/Foster Care \* |  | X |
| Alimony | X |  |
| Annuity | X |  |
| Black Lung Benefits |  | X |
| Bonus | X |  |
| Car Allowance | X |  |
| Child Support \* |  | X |
| Civil Service Retirement/Civil Service Annuity | X |  |
| Commission/Incentive | X |  |
| Disability |  | X |
| Farm Income | X |  |
| Housing Allowance | X |  |
| Interest and Dividends | X |  |
| Military Allotment (Housing and Food) |  | X |
| Mortgage Interest Differential | X |  |
| Non-Taxable Interest |  | X |
| Note Income | X |  |
| Overtime | X |  |
| Part-Time/Second Job | X |  |
| Railroad Pension |  | X |
| Rental Income | X |  |
| Retirement - Pension/IRA | X |  |
| Royalty/Lease Income | X |  |
| Salaried | X |  |
| Seasonal Income | X |  |
| Self-Employed Income | X |  |
| Social Security Retirement/SSA Benefits |  | X |
| Supplemental Security Income \* |  | X |
| Survivor Benefits |  | X |
| Tips and Gratuities | X |  |
| Trust Income | X |  |
| Unemployment | X |  |
| Union Members | X |  |
| VA Benefits/VA Disability |  | X |
| Welfare/Public Assistance |  | X |
| Workers Compensation |  | X |

\* A copy of the most recent tax return is not required to gross-up income.

**Multiple Income Sources**

To verify multiple acceptable income sources, apply the most conservative credit policy documentation requirements.

**Income That Cannot Be Considered**

Income must be reasonable and consistent with the customer's application. When calculating an applicant's income, certain types of income cannot be considered, including use as a compensating factor. These include:

* Non-verifiable income
* Income of a temporary or unknown origin
* Any income for a non-contractual party (for example, rental income without a lease agreement or evidenced on schedule E of the 1040)
* Income that is earned by a person who is not on the application. Income used to decision an application must be earned by the applicant(s) only. (For example, Underwriting may not use income earned by a spouse who is not on the application. To use income earned by both, spouses must be joint applicants. Income derived from illegal activities
* Income received as a gift

**Non-Taxable Income**

To gross-up income, the file must contain a complete copy of the most recently filed federal tax return evidencing the non-taxable status of the income, unless the income is from a source defined as non-taxable in all instances.

Use the factor 1.25 to gross-up acceptable sources.

**Note**: Non-taxable interest income is usually reflected on the front page of the personal tax return.

**Tax Return Requirements**

A minimum of two years signed personal tax returns from the borrower(s), including all schedules, is required, under the following circumstances:

* When the tax returns are needed to verify historic qualifying income amounts for certain salaried borrowers, investment income, and additional income sources.
* Self-employed borrowers (generally any borrower who owns 25% or more of a business)
* For commissioned borrowers (regardless of the percent of total annual income the commission represents)
* Borrowers employed by a family owned business, (but not self-employed), or employed by an interested party to the property sale, purchase, or financing transaction, regardless of the automated underwriting system messaging.

**Notes**:

* These borrowers are not eligible for reduced income documentation (full documentation only).
* When the borrower's original signature does not appear on the copy of the return, the borrower must sign the return prior to closing.

An executed 4506-T (IRS Tax Transcripts) may be used as an alternative to signed tax returns. See the Internal Revenue Service (IRS) Form 4506-T and [Use of Executed 4506-T (IRS Tax Transcripts) in Lieu of Tax Returns](http://mbpp.jpmchase.net:8090/Credit_Policy/General_Income_Statement_Verification_Requirements.htm#Use_of_Executed) sections below for more information.

**IRS Tax Extensions**

Underwriting Institute allows the use of IRS Tax Extensions based on the following requirements:

* For applications dated prior to October 15th:
  + When tax returns are required and the tax filing deadline has passed without the borrower filing, obtain evidence that the borrower has filed for an extension.
* For applications dated on or after October 15th:
  + The use of a Tax Extension is not permitted. The current year's IRS-filed Tax Return must be obtained.

**Internal Revenue Service (IRS Tax Transcripts) form 4506-T**

**Lending Direct - Mortgage**

Obtain a completed and signed 4506-T on every application and ensure it is in the loan when submitted to Underwriting.

In addition, execute the 4506-T and retain 2 years of IRS transcripts in the loan file when:

* Conditioned by Underwriting
* Required by the transaction
* The loan is Non-Agency

See Transactions Requiring an Executed 4506-T below.

When misrepresentation is suspected, forward the file and findings to Loan Integrity Operations for review.

See 4506-T Requirements for relevant procedures.

See IRS 4506-T for an electronic copy of the form.

**Lending Direct - Home Equity**

Obtain a completed and signed 4506-T on every conditionally-approved application. For a final-approved transaction, the completed form must be retained in the loan file.

In addition, execute the 4506-T and retain 2 years of IRS transcripts in the loan file when:

* Conditioned by Underwriting
* Required by the transaction

See Transactions Requiring an Executed 4506-T below.

When misrepresentation is suspected, forward the file and findings to Loan Integrity Operations for review.

**Use of Executed 4506-T (IRS Tax Transcripts) in Lieu of Tax Returns**

Unless restricted by a specific Product Guide, Agency, Non-Agency and Home Equity products allow for the use of an executed 4506-T (IRS Tax Transcripts) as an alternative to obtaining the borrower’s signed and dated personal and/or business tax returns to document qualifying income for sources normally requiring tax returns.

Additionally, when the loan file contains unsigned tax returns, an executed 4506-T (IRS Tax Transcripts) may be used as an alternative to requiring the tax returns to be signed.

The following requirements apply:

* The IRS Tax Transcripts must be obtained directly from the IRS by the Lender, or through an approved vendor, by using a fully executed 4506-T.
* The IRS Tax Transcripts must meet the required number of years for qualification of the specific income source.
* The IRS Tax Transcripts must contain the same information that would be required by Agency guidelines, and would normally be included in the borrower’s official IRS Tax Returns, including all applicable schedules.

*All* of the above requirements must be met, or complete signed and dated tax returns are required.

**Note**: The IRS Tax Transcripts may also be used in lieu of IRS W-2 Forms when all of the required information is contained in them.

Click for procedures.

**Transactions Requiring an Executed 4506-T**

An executed 4506-T is a borrower-completed and signed form that has been processed by the IRS and contains income information for the years requested; two (2) years of income must be requested. Lending Book uses an approved vendor as our access point into the IRS.

**Lending Direct - Mortgage**

**Note**: An executed 4506-T is required on all Non-Agency loan transactions.

All transactions and borrower types listed below require an executed 4506-T, unless an exempt loan type:

* All Non-Agency loan products
* Self-employed borrowers
* Borrowers employed by a family member
* Borrowers who currently own rental property
* Borrowers currently employed in the mortgage or real estate industries (including but not limited to real estate sales, property management, a mortgage broker, mortgage banker or operations staff, a real estate investor, or a builder or developer)
* Borrowers appearing to have a real estate speculation or straw buyer profile, as evidenced by multiple mortgages appearing on the credit report for short durations
* A party to a non-arm's length transaction
* Financing on a distressed property, including financing properties that are short sales or REOs
* Loans secured against properties located in the state of Florida
* Loans in which stated owner occupancy is determined to be questionable
* Loans identified by High Risk as "High Risk" Employment/Income
* Borrowers with prior serious derogatory credit issues (Foreclosure, Bankruptcy or Short Sale/Forgiveness of debt) in past 48 months
* All Conventional Loan transactions Requiring Private Mortgage Insurance (LTV greater than 80%)
* All non-owner occupied and Second/Vacation Homes loans
* Transactions involving Conversion of Primary Residence (see Conversion of Primary Residence)
* All cash out refinance transactions, excluding:
  + VA IRRRL transactions
  + VA refinances paying off only liens secured by the subject property and with less than $500 cash back to borrower
* Any loan where the LTV exceeds 70%, and any of these conditions exist:
  + 3-4 Unit Properties
  + DTI greater than 40% (excludes FHA and VA loans)
  + Less than six (6) months liquid reserves (purchase transactions only, and excludes FHA and VA Loans)

**Lending Direct - Home Equity**

All transactions and borrower types listed below require an executed 4506-T, unless an exempt loan type:

* Self-employed borrowers
* Borrowers employed by a family member
* Borrowers who currently own rental property
* Borrowers currently employed in the mortgage or real estate industries (including but not limited to real estate sales, property management, a mortgage broker, mortgage banker or operations staff, a real estate investor, or a builder or developer)
* Borrowers appearing to have a real estate speculation profile, as evidenced by multiple mortgages appearing on the credit report for short durations
* Loans secured against properties located in the state of Florida
* Loans in which stated owner occupancy is determined to be questionable
* Loans identified by High Risk as "High Risk" Employment/Income
* Borrowers with prior serious derogatory credit issues (Foreclosure, Bankruptcy or Short Sale/Forgiveness of debt) in past 48 months
* Any loan where the LTV exceeds 70% and DTI greater than 40%

**Exempt Loan Types**

**Lending Direct - Mortgage**

The following loan type and program is exempt from a 4506-T at time of application and closing and therefore also exempt from execution:

* Agency Streamline HARP refinance loans (Refi Plus and Relief Refi) not requiring income qualification (i.e. payment shock <= 120%)

The following loan types and programs are exempt only from 4506-T **execution** but still require a completed and signed 4506-T be obtained at time of application and closing:

* VA non-credit qualifying IRRRL loans
* Underwriting Institute employee loans (Underwriting retains discretion to execute 4506-T for other reasons)

**Lending Direct - Home Equity**

See the Exceptions section below.

The following loan types are exempt from 4506-T execution but still require a completed and signed 4506-T be retained in the loan file:

Employee loans (Underwriting has discretion to execute for other reasons)

**Borrower's Application - FNMA 1003/FHLMC 65 (Financial Statement)**

**Lending Direct - Mortgage**

Lending guidelines require an initial application for all borrowers. The application:

* Functions as the borrower's financial statement
* Identifies the borrower and their request for credit
* Serves as the borrower's validation of the information disclosed

After all information on the initial application has been received and verified, a final application is prepared and signed by the borrower at closing.

**Note**: On stated income products, or AUS findings, the application serves as the source of information for employment and income.

**Lending Direct - Home Equity**

Not applicable.

**Exceptions**

**Lending Direct - Mortgage**

Refer to Exceptions and Conventional First Mortgage Exception Requests policy topics for guidance on the First Mortgage exception process and requirements.

**Lending Direct - Home Equity**

Variance to level of documentation requirements for income verification must be approved and documented by a Lender Level 4 or higher. The exception must not hinder the credit decision with insufficient and inadequate documentation (e.g., one pay stub to verify commission income).

Any exception made where income verification is not received (i.e., Stated Income), *and* the loan is not originated or closed in the Banking Center Channel, requires a Request for Transcript of Tax Return (IRS Form 4506-T) to be executed at time of loan closing. See

**Employment Income - Salaried Sources**

**Policy**

Salaried borrowers are individuals who have less than 25% ownership in the business from which they derive their salary. These borrowers receive annual or hourly wages, or commission.

Refer to General Income Statement - Verification Requirements for qualifying income sources and taxable status.

* A borrower who is not self-employed but employed by a family-owned business, or is employed by an interested party to the property sale, purchase, or refinance transaction, may represent a less predictable source of income. Copies of the last two years income tax returns, filed with the IRS, are required.
* These borrowers are not eligible for reduced income documentation programs (Full Documentation only).
* See Arms Length/Non-Arms Length Transactions for more information.

**General Income Verification Requirements**

When documentation shows that the applicant has maintained a consistent level of income despite changes in the sources of income, the stability of that income level may be presumed.

**Example**: An applicant may change jobs frequently but is nonetheless able to earn consistent and predictable income.

**Employment Contracts**

An employment contract is a legally enforceable written document executed jointly by the employer and employee. The contract will define pertinent employment details such as employment start date, length of employment, salary and may also include such things as benefits and other related terms of employment. Employment agreements and offer letters are additional forms of employment contracts, provided that they are fully executed by all parties and afford the same information as previously described.

A borrower may be qualified utilizing the income documented in the employment contract provided:

* the employment contract is fully executed by the employer and employee and does not contain contingencies;
* the borrower will begin employment prior to the loan closing;
* the terms of the contract are deemed reasonable by Underwriting; and
* the loan application and file documentation verify the required minimum two-year employment history for the borrower. Underwriting may elect to accept college transcripts in lieu of employment history.

**Note:** A verbal Verification of Employment must be completed prior to the loan closing confirming that the borrower has started their employment based on the terms reflected in the employment contract.

**Temporary Leave of Absence**

Lending Guidelines will consider regular employment income or other alternative short-term sources of income from a borrower that is on a temporary leave of absence, even if the borrower will not be returning to work at the time of closing. Acceptable reasons for the leave of absence include maternity or parental leave, short-term medical disability, Workman's Compensation, or other temporary leave types that are acceptable by law or the borrower’s employer provided the following conditions are met:

* Written verification from the borrower confirming:
  + their intent to return to work upon completion of the leave of absence, under the same terms as prior to the leave, and
  + the agreed upon date of the return to work;
* Written verification from the borrower’s employer confirming:
  + the borrower’s continued employment with the company.
  + the borrower’s return date.
  + the borrower’s post-leave employment and income will be under the same terms as prior to the leave.
* Verbal Verification of Employment (VVOE) following standard policy & procedures.

**Income Verification Requirements**

Verification of borrower’s income is required as follows:

* standard documentation of the amount of regular employment income the borrower received prior to the temporary leave.  This includes, but is not limited to base pay, overtime, commissions and bonus income.
* documentation evidencing the amount and duration of all income sources being used to qualify the borrower during the temporary leave of absence period.
* if needed, documentation verifying all available liquid assets used to supplement a reduced income for the duration of the temporary leave of absence period.

**Calculation of Qualifying Income**

If it is verified that the borrower **will** return to work at their current employer as of the first mortgage payment date:

* the borrower's regular employment income (i.e. gross monthly income) that will be received upon return to work can be used for loan qualification purposes

If the borrower **will not** return to work as of the first mortgage payment date:

* use the lesser of the borrower's temporary leave income that will continue to be received for the duration of the leave of absence period (if any) or regular employment income

**Use of Supplemental Income**

If the temporary leave income is less than the regular employment income and is not sufficient to qualify, available liquid financial reserves may be used supplement the temporary leave income. Supplemental income, if applicable is calculated as follows:

Supplemental income amount = available liquid reserves divided by the number of months of supplemental income

* **Available liquid reserves**: subtract any funds needed to complete the transaction (down payment, closing costs, other required debt payoff, escrows, and minimum required reserves) from the total verified liquid asset amount.
* **Number of months of supplemental income**: the number of months from the first mortgage payment date to the date the borrower will begin receiving his or her regular employment income, rounded up to the next whole number.

After determining the supplemental income, calculate the total qualifying income as follows:

* Total qualifying income = supplemental income plus the temporary leave income

**Note**: The total qualifying income that results may not exceed the borrower's regular employment income.

**Important**: If a borrower is not currently on temporary leave, Lender Employees must not ask if he or she intends to take leave in the future.  In addition, under no circumstances should any information regarding a borrower’s personal medical history or condition be requested from the borrower or any third party source.

**Overtime Salary Income**

Overtime income may fluctuate from year to year. Use an average of the last two years of income to qualify the borrower, and consider the annualized YTD earnings.  Annual earnings that are level or increasing from one year to the next are considered stable.  However, if the trend for the overtime income shows a decline, earnings should not be averaged and must be carefully analyzed before considering as stable income.

To use overtime income to qualify a borrower, the following requirements must be met:

* The borrower must have a consecutive, recent, two-year history of receiving overtime income.
* The overtime income must be stated separately for the past two years and YTD period.
* The overtime income must be reasonably expected to continue.
* Overtime income must be documented on W-2s, tax returns, and/or paystubs for the past two years and YTD period.

**Note**: **Lending Direct -  Mortgage Only:** See the Use and Calculation of Overtime Income topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.

**Partial Year Income**

Certain borrowers (e.g., teachers and forest fire fighters) may be paid for only part of the year. Underwriting must ensure that the monthly qualifying income calculation considers this partial-year employment. To determine partial-year qualifying income, the monthly salary is multiplied by the number of months the borrower is paid and divided by 12 (i.e., "annualizing" the income).

**Seasonal Income**

Seasonal income is a recurring but temporary source. To use seasonal income to qualify the borrower, there must be:

* A two-year historical record of earnings.
* A most recent pay stub and previous two (2) years' W-2s documented in the file.
* Reasonable expectations the income is likely to continue.

**Part-Time or Second Job Income**

To use part-time or second job income, carefully consider the source and sustainability of the income. In addition, the following is required:

* There must be a minimum 24-month history for the second job to include it in the debt ratio (DTI) calculation.
* A recent pay stub showing YTD earnings.
* Previous two years' W-2s.
* The income must be reasonably expected to continue.

**Note**: **Lending Direct -  Mortgage Only:** See the Use and Calculation of Part-Time/Second Job Income topic in the [Lender Underwriting Policy](http://mbpp.jpmchase.net:8090/Retail_Policies_and_Procedures/BWG_Evaluation_Tool.htm) for additional information, including documentation requirements and detailed calculation methods.

**Bonus Income**

To use bonus income in the qualification, Underwriting must carefully consider the source, and method paid, and the basis upon which the income is earned (e.g., personal sales or company profit).  Annual earnings that are level or increasing from one year to the next are considered stable.  However, if the trend for the bonus income shows a decline, earnings should not be averaged and must be carefully analyzed before considering as stable income.

To use bonus income in the qualification:

* Document a consecutive, recent, two-year history with the same employer.
* A YTD pay stub reflecting bonus income received is required.
* It must be stated separately for the recent two-year period.
* It must be reasonably expected to continue.
* Copies of the borrower's W-2s and/or signed federal income tax returns for the past two years are required.
  + Tax returns must have been filed with the IRS.

**Notes**:

* Projected bonus income that has no historical basis is not an acceptable source of income.
* **Lending Direct - Mortgage Only:**  See the Use and Calculation of Bonus Income topic in the Lender Underwriting Policy additional information, including documentation requirements and detailed calculation methods.

**Commissioned Borrowers**

Commission income may fluctuate from year to year. Use an average of the last two years of income to qualify the borrower, and consider the annualized YTD earnings. Annual earnings that are level or increasing from one year to the next are considered stable. However, if the trend for the commission income shows a decline, earnings should not be averaged and must be carefully analyzed before being considered as stable income.

To include commission income in the qualification:

* Document a consecutive, recent, two-year history in the same field.
* It must be stated separately for the recent two-year period.
* It must be reasonably expected to continue.
* Copies of the borrower's YTD paystub/income statement, W-2s (or 1099s) and signed federal income tax returns for the past two years are required. Tax returns must have been filed with the IRS.

**Notes**:

* Commission income reported on the tax returns must cover at least a 12-month period and any non-reimbursed business expenses should be deducted from the income. Generally, these expenses are averaged, unless increasing.
* Non-reimbursed business expenses are reflected on Schedule A and Form 2106 of the tax returns.
* **Lending Direct - Mortgage Only** 
  + See the Use and Calculation of Commission Income topic in the Lender Underwriting Policy additional information, including documentation requirements and detailed calculation methods.
  + Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**Tips and Gratuities**

Income derived from tips and gratuities is permitted as follows:

ONLY verified amounts are allowed.  An employer, as part of an employee's normal wages, must report tip income. Applicant(s) must, at a minimum, provide copies of the two (2) most recent W-2s, a current pay stub showing YTD earnings, and two (2) most recent tax returns with all schedules.

**Employment Income - Self-Employed Sources**

**Policy**

Self-employed income comes from an enterprise the borrower owns outright or substantially controls. An ownership share of 25% or more, or a combined ownership share of 25% or more for multiple applicants, determines "substantial control."

Refer to General Income Statement - Verification Requirements for qualifying income sources and taxable status.

Analyze a self-employed borrower's business to determine that income streams are reasonable and likely to continue. The determination must validate the business is:

* profitable and viable.
* generating sufficient cash-flow to fund internal business needs.
* able to provide the owner (borrower) with sufficient income to repay all debt obligations.

**Notes**:

* Tax returns must be obtained regardless of whether the income is being used to qualify, to determine if there is a business loss that may have an impact on the stable monthly income used for qualifying.
* **Lending Direct - Mortgage Only:** Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**General Requirements for Self-Employed Borrowers**

Self-employed borrowers should exhibit the following stability standards:

* Minimum of two years operating the same business
* Potential for maintaining continuous operation of business and income
* Documented ability to meet current and future obligations when income is fluctuating or diminishing
* Independent verification, prior to closing, that the borrower is self-employed

The following are required for all self-employed borrowers:

* A 24-month history of self employment, regardless of prior work history
* A minimum of two (2) years self-employment, reflected on tax returns

**Notes**: **Lending Direct - Mortgage Only**

* A P & L Statement prepared by a CPA for any time period within the last two (2) years that is not reflected on the tax returns
* See the Use and Calculation of Self Employed Income topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.

**Documentation Requirements**

The following documentation is required for all self-employed borrowers:

* A minimum of the last two years of tax returns, signed by the borrower, including all schedules and statements
* Internal Revenue Service (IRS) Form 4506-T; see the corresponding section in General Income Statement - Verification Requirements

**Lending Direct - Mortgage**

* When tax returns are required and the tax-filing deadline has passed without the borrower filing, obtain a properly executed notice of extension for our review and loan file. See Tax Transcripts in the Underwriting Operations section of this guide for additional information.
* A year-to-date (YTD) P & L Statement may be required by an Automated Underwriting System (AUS) when the application is dated more than 120 days after the end of the business' fiscal year, regardless of the type of business.
* See the Use and Calculation of Self Employed Income topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.

**Lending Direct - Home Equity**

* A copy of executed extension for personal tax return is required for both initial documentation filed on April 15 and subsequent extension through October 15.

**Notes**: These apply to **Lending Direct - Mortgage** and **Lending Direct - Home Equity:**

* When any borrower on the loan application is self-employed, and the self-employment income is not used to qualify, obtain tax returns to determine if there is a business loss that may impact the stable monthly income used for qualifying.

**Self-Employed Business Losses**

Self employed business losses must be considered as part of the underwriting and risk assessment of the loan file. The amount of any losses incurred by the business must be deducted from qualifying income, based on the borrower’s percentage of ownership in the business.

**Note**: Losses are also considered in the analysis of the business as indicated in the Policy section above.

**Contract Employees**

Lending Book considers contract borrowers (borrowers paid on an independent, contractual basis) to be self-employed borrowers. Contract borrowers must provide the same documentation as self-employed borrowers.

**Note**: **Lending Direct - Mortgage Only**: Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**Sole Proprietor**

A sole proprietor generally files a Schedule C with personal tax returns to report business income.

Income verification requirements are:

* A minimum of the last two years tax returns, signed by the borrower, including all schedules, and statements.
* When the returns are insufficient to analyze the business, request supplemental financial information, such as interim financial statements.

**Notes:  Lending Direct - Mortgage Only**

* When tax returns are required and the tax-filing deadline has passed without the borrower filing, obtain a properly executed notice of extension for our review and loan file. See Tax Transcripts in the Underwriting Operations section of this guide for additional information.
* See the Use and Calculation of Self Employed Income topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.
* Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**Partnership**

Partnership income is generally reflected on the Schedule K-1 and contains income from the borrower's personal tax returns as well as from the partnership returns.

When the borrower, or multiple borrowers, controls 25% or more of the business, the following minimum requirements apply:

* Personal tax returns as indicated in General Requirements for Self-Employed Borrowers section above
* Two (2) years of K-1s from the Partnership to the individual

**Notes**: **Lending Direct - Mortgage Only**

* Two (2) years of the most recent Partnership Tax Returns (1065s)
* See the Use and Calculation of Self Employed Income topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.
* Use Fannie Mae Automated [1084 Self-Employed Worksheets](http://sharepoint.jpmchase.net/Sites1/SPggxlfh/Credit%20Policy%20%20Collateral%20Forms%20%20Job%20AIds/1084_schedules.xls) to analyze income.

**Corporation**

When the borrower, or multiple borrowers, controls 25% or more of the business, the following minimum requirements apply:

* Personal tax returns as indicated in General Requirements for Self-Employed Borrowers section above
* Corporate financial statements are useful as a supplement, but are not substitutes for the Corporate Tax Returns.
* Two (2) years of K-1s from an "S" Corporation to the individual.

**Notes**: **Lending Direct - Mortgage Only**

* Two (2) years of the most recent Corporate Tax Returns (1120s or 1120Ss, if applicable)
* See the Use and Calculation of Self Employed Income topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.

**Use of Profits from a Corporation**

To use "net profits" from a Corporation as qualifying income, the borrower(s) on the application must have *complete (100%) ownership of the Corporation* as evidenced by the business tax returns or a letter from the accountant for the business.

The following requirements must also be met:

* The borrower(s) must have a legal right to the additional income as evidenced by a corporate resolution or other comparable document.
* There must be a minimum two (2) year history of receipt of the income.
* Verification from the accountant for the company indicating that the business can support the on-going distribution of the corporate profits at the same or an increasing level.
* Underwriting's analysis of the business that supports it is capable of providing the borrower(s) with the additional income.

**Notes**:

* The requirements above do not apply to "S" Corporations.
* **Lending Direct - Mortgage Only**: Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**Limited Liability Company (LLC)**

Limited Liability Companies file taxes using partnership tax returns.  Apply the partnership tax return requirements above to these companies.

**Other Income**

**Policy**

Other income sources, taxable and non-taxable, must be verified unless otherwise indicated by underwriting and/or specific program guides.

Distinguish non-taxable income from non-reported income. Non-taxable income sources are not taxed, resulting in a greater "value" to the borrower. Unless otherwise noted, all non-taxable income sources are grossed up by a factor of 1.25, provided the non-taxable status of the income is verified. See General Income Statement - Verification Requirements for specific non-taxable income details.

See General Income Statement – Verification Requirements for qualifying income sources and taxable status.

The table below outlines income types and the corresponding taxable or non-taxable status of each source.

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Type** | **Taxable** | **Non-Taxable** | **\*** |
| Alimony/Separate Maintenance | X |  |  |
| Automobile Allowance | X |  |  |
| Boarder Income | X |  |  |
| Child Support |  | X |  |
| Permanent Disability - Examples include but are not limited to:   * Black Lung Benefits * Social Security Disability * Private Insurance Disability * VA Disability | X | X | \* |
| Foster Care |  | X |  |
| Gift | N/A | N/A |  |
| Housing Allowance | X |  | \* |
| Military Allotment  Examples on non-taxable income include but are not limited to:   * Housing (BAH) * Rations (BAS) |  | X | \* |
| Mortgage Credit Certificates | N/A | N/A |  |
| Mortgage Interest Differential | X |  |  |
| Non-qualifying | N/A | N/A |  |
| Non-reported | N/A | N/A |  |
| Public Assistance - Examples include but are not limited to:   * Aid to Dependent Children * Welfare Benefits, including food stamps |  | X | \* |
| Relocations/Trailing Co-applicant | N/A | N/A |  |
| [Retirement/Pension](http://mbpp.jpmchase.net:8090/Credit_Policy/Other_Income.htm#Retirement) - Generally, the majority of pension income is taxable. Examples of non-taxable income include but are not limited to:   * Civil Service Annuity * Civil Service Retirement * Rail Road Retirement/Pension | X | X | \* |
| Section 8 Homeownership Assistance Payments |  | X |  |
| Social Security - Retirement | X | X | \* |
| Social Security - Survivor Benefits | X | X | \* |
| [Supplemental Security Income](http://mbpp.jpmchase.net:8090/Credit_Policy/Other_Income.htm#Supplemental) (SSI) |  | X |  |
| Unemployment | X |  |  |
| Union Members | X |  |  |
| Veterans Benefits | X | X | \* |

\*There are situations where additional documentation is required to determine the portion of a borrower's income that is non-taxable. The non-taxable portion is grossed up provided the non-taxable status of the income is verified. See General Income Statement Verification Requirements – Non Taxable Income for additional details and requirements.

* Employment Income – Salaried Sources
* Employment Income – Self-Employed Sources
* Investment Income

**Note:** **Lending Direct - Mortgage Only:**

Defer to Automated Underwriting System (AUS) findings or messages.

**Alimony, Child Support and Separate Maintenance**

When the borrower discloses receipt of alimony, child support or separate maintenance income, it may be included as qualifying income, following the documentation and seasoning requirements listed below.

**Documentation Requirements**

* A minimum of six (6) months' proof of receipt
* Any one of the following is an acceptable proof of receipt:
  + Court documents
  + Bank statements
  + Bank deposit slips
  + Tax returns
  + Cancelled checks

**Note**: Income received for less than six (6) months is considered unstable and may not be used towards loan qualification. In addition, if payments are not for the full amount or are made on an inconsistent or sporadic basis, the income is not acceptable.

**Seasoning Requirements:**

* Proof of obligation for the past six (6) months is documented with a copy of any of the following:
  + The divorce decree
  + A signed separation agreement
  + A notarized agreement as dictated by local custom

**Alert**: Documentation must support that the alimony, child support or separate maintenance income will continue for at least three years. In addition, if the income source is from Child Support then proof of the ages of the children receiving the support is required to confirm a three-year continuance of the income.

**Note**: Alimony payments are found on the front page of the personal tax return.

**Automobile Allowance**

An automobile allowance may be included in qualifying income provided evidence of receipt for two years is documented with one of the following:

* Written verification from the employer
* Pay statements

The automobile payment must be added to the liabilities and included in the borrower’s debt-to-income ratio (DTI), while the full amount of the auto allowance is added to the qualifying income.

**Boarder Income**

**Lending Direct - Mortgage**

* Non-Affordable Loan Product
  + Boarder income is not eligible as qualifying income with a non-affordable loan product.
* Affordable Loan Product
  + Boarder income is acceptable with an affordable product. The property must be an owner-occupied, single family home, and the borrower must claim the  income on tax returns.
  + Verification is required with both of the documentation sources below:
    - The last two (2) years 1040s, including Schedule E
    - A copy of a current lease

**Lending Direct - Home Equity**

Not a permitted source of income.

**Permanent Disability Income**

Permanent Disability (AKA Long-Term Disability) income may be included as qualifying income. The borrower's current eligibility, amount and terms of the payment are verified with:

* Copies of the most recent two (2) months bank statements or check stubs, and one of the following:
  + A copy of the awards letter
  + Other verification provided by:
    - The employer
    - Insurance company
    - Government agency (i.e., Social Security Administration or Veterans Administration)

Generally, long-term disability will not have a defined expiration date and must be expected to continue. The requirement for re-evaluation of benefits is not considered a defined expiration date.  For temporary or Short-Term Disability situations (including Workman’s Compensation), see the Temporary Leave of Absence section in the Employment Income - Salaried Sources topic

**Alert:** Lending Book never requests any medical documentation or makes any inquiry regarding the nature of the disability or its duration. Any discussion regarding a borrower's disability should be limited to a request for the required documentation outlined above.

**Foster Care Income**

Foster care income may be included as qualifying income provided both conditions below are met:

* Document receipt for the previous 24 months.
* Document the income is paid to the borrower by a governmental agency, and is verified by one of the following:
  + Copies of checks
  + Copies of contracts or agreements with the governmental agency.

**Gift Income**

Gift income, even if received on a regular and on-going basis, is not eligible income.

**Note**: Do not confuse gift income with a "one-time" gift of funds considered as assets to cover down payment, closing costs, etc.

**Housing Allowance**

Borrowers may be able to use certain housing allowances (i.e., military or clergy) as qualifying income provided all of the following conditions are met:

* The housing allowance has a history of being a part of a salary.
* The amount of the allowance is verified in writing by the employer.
* There is proof of receipt of the income for the most recent 12 months.
* Use the lower amount of monthly income when the allowance is declining.

**Note**: This requirement applies to non-military housing allowances only.

**Military Allowances**

Military personnel often receive supplemental income allowances (paid by allotment) in addition to regular base salary income.  Allowances may or may not be taxable.

The following supplemental income amounts can be used for military personnel provided the pay is verified in writing by the branch of the military in which the borrower serves, and conforms to the standard income continuance requirements:

* Flight or hazard pay
* Pro-pay (professional pay)

The following additional supplemental income allowances for military personnel are grossed up by a factor of 1.25 percent, as they are non-taxable:

* Housing (BAH)
* Rations (BAS)

Click Military Compensation - Allowances for additional information on military allowances and non-taxable statuses.

**Mortgage Credit Certificates**

Mortgage Credit Certificates are not used as income or reduction of a housing payment for purposes of qualifying the borrower. The certificates are eligible as a tax credit only for First Time Homebuyers on a Purchase transaction.

State Bond and Mortgage Credit Certificates Programs - Approval Process for information on the eligibility and approval process.

**Mortgage Interest Differential**

Mortgage interest-rate differential payments are used as qualifying income provided the employer verifies the amount, terms and payment method for the payment.

The employer cannot be an interested party to the transaction.

**Note**: When the payment amount fluctuates, use an average.

**Alert**: Mortgage differential payments cannot be subtracted from the PITI payment on the mortgage.

**Non-qualifying Income**

There are a variety of other sources of income, such as stable short-term income, that cannot be included in qualifying income or as a compensating factor for a high payment or high debt-to-income (DTI) ratio.

**Non-reported Income**

Non-reported income (aka "undocumented" income) cannot be used as a qualifying income source.

**Public Assistance**

Public Assistance is used as qualifying income and must be verified with:

* Copies of the most recent two (2) months bank statements or check stubs, and one of the following indicating proof of receipt for the previous 24 months:
  + Copies of award letters
  + Copies of grant statements

**Relocations or Trailing Co-applicant Income**

Trailing co-applicant income cannot be used as part of qualifying income.

**Retirement or Pension Income**

Retirement or pension income, and retirement assets that have been set up for regular distribution payments, are used as qualifying income.

When the source of income is the previous employer, government agency or military retirement plan, continuance does not need to be addressed unless there is evidence to the contrary. Retirement or pension income, and continuance, when necessary, must be verified with:

* Copies of the most recent two (2) months bank statements or check stubs, and one of the following:
  + Written verification from the organization paying the income
  + A copy of the most recent award letter
  + Most recent two (2) years 1099 tax forms
  + Most recent two (2) years personal tax returns

**Alert**: All assets used for income qualification cannot be used for closing costs or reserve requirements, exceptions must be approved by the BWG Specialized Team.

**Note**: Annuitization of retirement or pension assets must conform to agency policy (see Annuitization of Employment Related Assets ) or approved by Exceptions Desk

**Section 8 Homeownership Assistance Payments**

Section 8 homeownership assistance payments that are paid directly to the borrower may be considered qualifying income. The payments may not be used to offset the monthly housing payment amount used for qualification. The borrower must provide documentation that shows the amount and terms of the monthly payment received from the public housing agency that issued the voucher. The documentation must reflect that the payments are made directly to the borrower. Section 8 homeownership assistance payments must be likely to continue for the next three years.

**Note**: All Section 8 Homeownership Programs and PHAs must be approved by Underwriting Institute prior to submitting a loan application.

**Social Security Income**

Social Security income is used as qualifying income provided it is verified with:

* Copies of the most recent two (2) months bank statements or check stubs, and one of the following:
  + A copy of the Social Security Administration (SSA) award letter
  + Most recent one year 1099 tax form
  + Most recent one year personal tax return

The following suffixes to the Social Security Number (SSN) indicate the type of benefit received:

* A - Disability or retirement
* B - The person is alive and the spouse is receiving the benefit
* C - Child beneficiary
* D - The person is deceased and the surviving spouse is receiving the benefit.

Social security income is found on the front page of the personal tax return.

**Survivor Benefits for Minor Children**

Survivor benefits for minor children are counted as income to qualify for a loan. Copies of the most recent two (2) months bank statements or check stubs and a copy of the awards letter (or equivalent documentation) are required for verification.

**Supplemental Security Income (SSI)**

Supplemental Security Income is included as qualifying income provided it is verified with both of the following:

* Copies of the most recent two (2) months bank statements or check stubs
* A copy of the awards letter (or equivalent documentation)

**Unemployment Income**

Unemployment compensation, (received by seasonal workers), may be considered as acceptable stable income provided it:

* Is properly documented
* Has been received for the past two (2) years
* Is predictable and likely to continue

**Note**: Unemployment income is found on the front page of the personal tax return.

**Veterans Benefits**

Veterans benefits are included as qualifying income provided the income is verified with one of the following:

* A letter or distribution form
* A statement of earnings from the Department of Veterans Affairs (VA)

**Note**: Educational assistance may not be used as qualifying income.

**Union Members**

Average income from direct union job assignments using both of the following sources of documentation:

* The last two years W-2s from all employers
* Year-to-date (YTD) earnings from current pay stubs or statements

**Subject Property and Non-subject Property Income Verification Requirements**

**Subject Property Income Verification Requirements**

**Alert**: To use the rental income from investment properties as a qualifying income source, the borrower must demonstrate at least a two-year history through tax returns of managing 1-4 unit investment properties, in addition to requirements in these tables. The two-year management history must be consecutive and must have occurred (in part or in whole) during the 36 months prior to the mortgage application date.

This table provides subject property income verification requirements:

|  |  |  |  |
| --- | --- | --- | --- |
| **Occupancy** | **Property Type** | **Seasoning Status** | **Income Verification** |
| Owner-occupied | 2-4 unit | Seasoned | Average seasoned income over the last two years, unless declining. Unless the automated underwriting (AU) systems state otherwise, verify by reviewing either of these documents:   * The two (2) most recent federal tax returns with the appropriate accompanying schedules and forms * The most recent tax return along with a current lease that reflects consistent gross rental income |
| Non-owner occupied (investment) | 1-4 unit |
| * Owner-occupied * Non-owner occupied (investment) | 2-4 unit | Unseasoned | Determine income (cash flow) using the amount calculated on the appraiser-provided "*Operating Income Statement*" (FNMA Form 216). |
| Non-owner occupied (investment) | 1 unit | Unseasoned | Determine income (cash flow) using the amount calculated on these appraiser-provided schedules:   * "*Operating Income Statement*" (FNMA form 216) * "*Single-Family Comparable Rent Schedule*" (FNMA form 1007) |

**Non-subject Property Income Verification Requirements**

**Alert**: To use the rental income from investment properties as a qualifying income source, the borrower must demonstrate at least a two-year history through tax returns of managing 1-4 unit investment properties, in addition to requirements in these tables. The two-year management history must be consecutive and must have occurred (in part or in whole) during the 36 months prior to the mortgage application date.

This table provides non-subject property income verification requirements:

|  |  |  |  |
| --- | --- | --- | --- |
| **Occupancy** | **Property Type** | **Seasoning Status** | **Income Verification** |
| Owner-occupied | 2-4 unit | Seasoned | Average seasoned income over the last two years, unless declining. Unless the AU systems state otherwise, verify by reviewing either of these documents:   * The two (2) most recent federal tax returns with the appropriate accompanying schedules and forms * A current lease, if the property generating income does not appear on the most recently filed tax return - calculate using 75% of the income |
| Non-owner occupied (investment) | 1-4 unit |
| Owner-occupied | 2-4 unit | Unseasoned | Calculate unseasoned income using 75% of the income and, unless the AU systems state otherwise, verify the current lease. |
| Non-owner occupied (investment) | 1-4 unit |

**Investment Income**

**Policy**

Refer to General Income Statement - Verification Requirements for qualifying income sources and taxable status.

When personal tax returns are used to verify investment income, the following is required:

* A minimum of the last two (2) years of personal tax returns, including all schedules and statements, and signed by the borrower.
* Unless otherwise noted, all non-taxable income sources are grossed up by a factor of 1.25, provided the non-taxable status of the income is verified. See the Non-Taxable Income section of General Income Statement - Verification Requirements for details.

**Notes**: **Lending Direct - Mortgage Only**

* Use the IRS form 4506-T to validate the tax returns. See the corresponding sections in General Income Statement - Verification Requirements.
* When tax returns are required and the tax-filing deadline has passed without the borrower filing, obtain a properly executed notice of extension for our review and loan file. See Tax Transcripts in the Underwriting section of this guide for additional information.

**Annuity**

To use annuity income in the qualification, a formal and structured annuity agreement must exist through a guaranteed income vehicle.

**Notes**:

* Funds in the annuity or investment vehicle used as an income source may not be used as an asset source, and must be deducted from the available funds for the loan transaction.
* Any lump sum amount (whether it be Lottery Income, Bonus Income, Court Settlement, etc.) is not allowed as income unless it can be established that it is received in consistent amounts on a regular basis and meets all other annuity income requirements.

**Lending Direct - Mortgage**

See the Annuity Income topic in Lender Underwriting Policy for additional information and requirements.

**Note**: Implied annuitization of assets does not meet the requirements for use as Annuity Income. However, under certain circumstances, an income stream may be created from eligible assets and utilized as a source of qualifying income. See Annuitization of Assets below for additional information and requirements.

**Lending Direct - Home Equity**

Twelve (12) months of bank statements, most recent W2s, 1099s, or tax returns with all schedules are required in addition to the annuity agreement.

**Annuitization of Assets**

**Lending Direct - Mortgage**

In some cases implied annuitization and the creation of an income stream from employment related assets may be used as a source of qualifying income.  In order to be eligible, the assets must be liquid, owned solely by the borrowers, with unrestricted access and 100% of the balance available without penalty if the asset is a retirement account recognized by the IRS.  Examples of eligible assets include, but are not limited to:

* 401K
* IRA
* KEOGH

**Note**: Employer-based rollover funds are permissible.

**Note**: These assets are only eligible for use if distribution is not already set up or the distribution amount is not enough to qualify.  In addition, the account must be documented with the most recent statement.

**Non-Self Employed Severance and Lump Sum Retirement Packages**

Non-Self Employed Severance and Lump Sum Retirement Packages deposited into a retirement account:

* Must be documented with a distribution letter from the employer (1099R)
* Must provide evidence of deposit to a verified retirement account
* Must provide copies of the most recent three months personal depository or brokerage account statements

Non-Self Employed Severance and Lump Sum Retirement Packages **not deposited into a retirement account**:

* Lump-sum distribution funds must be derived from a retirement account recognized by the IRS (e.g., 401(k), IRA) and must be deposited to a non-retirement brokerage or depository account
* A borrower on the Mortgage must have been the recipient of the lump-sum distribution funds
* Parties not obligated on the Mortgage may not have an ownership interest in the account that holds the funds from the lump-sum distribution
* The proceeds from the lump-sum distribution must be immediately accessible in their entirety
* The proceeds from the lump-sum distribution must not have been or currently be subject to a penalty

**Ineligible Assets**

Examples of ineligible assets include, but are not limited to:

* Non-employment related assets (e.g., stock options, non-vested restricted stock, lawsuits, lottery winnings, sale of real estate, inheritance, divorce proceeds, etc.)

**Eligibility**

In order for eligible employment-related assets to be used as qualifying income, the following criteria must be met:

* The asset cannot already also be used as separate source of income,
* 70% Maximum LTV/CLTV/HCLTV,
* Minimum 700 credit score (AUS) or per eligibility matrix (manual),
* Purchase or limited cash-out refinance, and
* Principal residence (1-unit) or second home (1-unit). No investment properties.

**Income calculation**

Divide "net documented assets" by 360-Months (regardless of borrower age and current interest rate market.)

* Net documented assets = 70% of the sum of eligible documented assets minus any funds that will be used for closing costs or reserve requirements
* All assets used for income qualification cannot be used for closing costs or reserve requirements
* See Annuitization of Assets in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.

**Note**: If the employment related assets do not meet the requirements of this policy, they still may be eligible under other standard income guidelines, such as Annuity Income, Interest and Dividends Income or Retirement/Pension Income.

**Capital Gain or Loss**

Lending guidelines does not use capital gains or losses that arise from the sale of assets as qualifying income, or deductions to income, because they typically do not recur.

**Interest or Dividend**

To include interest and/or dividend income from cash or marketable securities in qualifying income, follow these guidelines:

* Verify that the underlying cash deposits and/or securities are currently held by the borrower.
* Subtract any funds required for closing on the subject transaction prior to the calculation of interest or dividend income.
* Average the year-to-date (YTD) interest and dividend income over the last two (2) years with the borrowers' tax returns, unless the income is declining.
  + YTD earnings can be calculated by applying a realistic market interest rate to the account balances and averaging over the number of months the income has been received for the year.
  + Do not include interest from pass-through tax entities (Partnerships and S Corporations), or from margined securities in the calculation of interest or dividend income.

**Notes**:

* Interest and dividend income is typically found on Schedule B of the personal tax return, but may be on Schedule D and Form 6252 - Installment Sales.
* **Lending Direct - Mortgage Only**: Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**Non-Taxable Interest or Dividend**

To use non-taxable income (e.g., municipal bond tax-exempt interest, etc) as qualifying income, Underwriting must:

* document the income with bank statements or award statements.
* verify a two (2)-year history of receipt of the income.

**Note**: See the Non-Taxable Income section of the General Income Statement – Verification Requirements topic.

**Investment Gain or Loss from Business**

Apparent gains or trivial losses on Schedule E of the personal tax return may indicate sizeable future liabilities or required contributions.

Analyze the Schedules E and K-1 to project future liability or qualifying income. The Schedule K-1 reveals contingent liabilities, historic capital contributions and possible future liabilities.

Any income derived from investment activity found on the Schedule E of the personal tax returns is based on a two (2)-year tax return analysis, and averaged, unless the income is declining.

**Note**:**Lending Direct - Mortgage Only**

Obtain a letter from the Partnership or S Corporation tax return preparer specifying future contributions, obligations, debt responsibility and income projections.

**Note Receivable**

To use interest income from a Note receivable:

* Obtain a copy of the Note
* The Note must be seasoned for a minimum 12 months
* Document receipt of the most recent twelve (12) payments
* Obtain the most recent two (2) years tax returns

**Notes**:

* Underwriting may require additional documentation when warranted.
* Alert:  **Lending Direct - Mortgage Only:** The Automated Underwriting System (AUS) may reflect different requirements for the twelve (12) month payment history; defer to the AUS requirements.

**Rental and Investment Property**

Rental or Investment property income may be used as qualifying income for owner-occupied and non-owner-occupied properties.

To use rental income from investment properties (either the subject property or non-subject property) in the qualification, the borrower must:

* Demonstrate at least a two (2) year history managing 1-4 unit properties for a consecutive period without gaps.
* Demonstrate that a portion of the consecutive period occurred at some point within the 36 months prior to the mortgage application date.
* Document the two (2) year management history on their tax returns.

**Note**: When rental income has been earned, but is not used in the qualification, include the full PITI in recurring debt.

**Income Calculation**

Income is calculated based on:

* Seasoning
* Property type
* Subject vs. non-subject property
* Occupancy

Regardless of the method used to calculate rental income, and for all categories in the topic above:

* When the amount is positive, add it to the qualifying income.
* When the amount is negative, add it to the recurring debts.

Rental and Investment properties fit into one of the following two (2) classifications:

* Residential - 1 to 4 unit residential
* Non-residential - any property that meets one of these criteria:
  + Has more than four (4) units
  + Is for commercial use
  + Is for industrial use

Income from rental or investment properties is designated as either:

* Seasoned - a one-year history reported on federal tax returns
* Unseasoned:
  + Does not have a one (1)-year rental history reflected on personal tax returns
  + Is a newly purchased investment property

**Note**: Specific product or program property standards may differ. Please review the product and program guidelines of this manual for specific products.

**Lending Direct - Mortgage**

* See Subject Property and Non Subject Property Income Verification Requirements.
* See [Conversion of Primary Residence](http://mbpp.jpmchase.net:8090/Credit_Policy/Conversion_of_Primary_Residence_PD_08_04.htm) for additional guidance.
* Use Fannie Mae Automated 1084 Self-Employed Worksheets to analyze income.

**Lending Direct - Home Equity**

* When the rental property has been leased less than 12 months, use 75% of the gross rental income and obtain a lease.
* When the rental property has been leased more than 12 months:
  + Two (2) most recent years tax returns with all schedules are be required.
  + When the two (2) most recent tax returns with all schedules are not available, the most recent tax return with all schedules and current lease agreement is required.
* Income generated from properties other than the collateral property may be used to "wash" the associated mortgage payment. See Rental Income Verification - 13.31.CD for additional information.
* Income generated from renting out a portion of a single unit Primary Residence occupied by the applicant (Boarder Income) is not permitted.

**Royalty and Lease (Other Than Real Estate)**

Carefully consider the source and method in calculating this type of income, and ensure that it is reasonable and likely to continue.

Royalty and lease income sources are found on Schedule E of the personal tax return.

To use royalty or lease income:

* Obtain copies of the contracts or leases.
* The income must have a two (2) year minimum history.
* Parties obligated to pay the leases or contracts must be identified.
* Use a two (2)-year average, unless the income is declining.

**Stock Options**

Corporate stock options are frequently used by an employer as an incentive to attract a "new hire" or to compensate an employee with a more direct interest in the success of the company.

Stock options are not permitted as a source of income. Values are subject to significant fluctuations, or may not be readily quantified. Additionally, there are often restrictions on when and how the options may be exercised.

**Trust**

Trust income is an acceptable source of income and is verified with a Schedule K-1, Schedule B, Schedule D, or Schedule E of the personal tax return, depending on the composition of the trust assets.

To use trust income, all of the following are required:

* A copy of the Trust Agreement
* Proof of receipt of the income for the most recent three (3) months
* Two (2) years most recent tax returns

**Notes**:

* When trust income constitutes 20% or more of the borrower’s qualifying income, the trust agreement must also be reviewed by Lender approved counsel.
* The legal review of the trust agreement is not a substitute for meeting the requirements to support the use of the income, and does not relieve Underwriting of the responsibility to ensure the income source is stable.

**Lending Direct - Home Equity Only**

The Trust Agreement must meet the following requirements:

* It is irrevocable.
* The applicant is the beneficiary.
* The balance and assets of the trust principle support the continuance of the income stream.
* There are no restrictive or beneficiary performance clauses that may stop, hinder, or reduce trust payments to the beneficiary.
* There are mandatory distributions or a history of previous distributions to the applicant.

**Credit Bureau Report Overview**

**Overview**

To assess a borrower's credit history, Lender obtains a credit report from a credit-reporting agency or by direct verification with a creditor. The credit report provides evidence of a borrower's payment history, as well as historical information about the borrower's "use" of credit.

The information credit bureaus report is Lenders primary measurement of the borrower's creditworthiness. Lending Book requires analysis of the borrower's current and past credit history through the review of a credit bureau report prepared by an independent credit-reporting agency or credit-reporting repository.

**Credit-reporting Repositories**

These are the three (3) major credit-reporting repositories:

* Equifax
* Experian
* TransUnion

**Acceptable Credit Reports**

Lending accepts these four (4) types of credit reports, which vary based on the mortgage request:

* In-file Credit Reports
* Merged Credit Reports
* Residential Mortgage Credit Report
* Non-Traditional Mortgage Credit Report

**Credit Bureau Report Requirements**

Lending requires a credit report for each borrower on the loan application with an individual credit record. One of the three major credit-reporting repositories must provide the data for the credit report.

**Traditional Credit Bureau Report Formats**

These are the acceptable formats for traditional credit bureau reports:

* In-file credit reports
* Automated merged credit report
* Residential Mortgage Credit Report (RMCR)

The credit report must be an original report, with no erasures, white-outs, or alterations.

**Required Information**

Traditional credit bureau reports must include credit and public record information for each locality in which a borrower has resided for a minimum of the previous two (2) years, and must include all discovered credit and legal information that the Fair Credit Reporting Act does not consider obsolete.

Credit reports must reveal payment history indicating any 30-, 60-, or 90-day past-due payments. If any of the information on a report is conflicting, use the most recent "date reported" information.

The credit report must include, but is not limited to, this information:

* Borrower full name
* Borrower address
* Telephone number of the reporting agency
* The names of the repositories the agency used to provide information for the report

Supplement a credit report received from a referral source (e.g., broker or correspondent) for an Automated Underwriting (AU)-approved loan with an in-file credit report when either of these is true:

* The AU approval does not acknowledge the report
* The report does not include a fraud alert

**Alert**: When a traditional credit search reveals that a borrower does not have a traditional credit record with a credit repository, refer to [Non-Traditional Credit Reports](http://mbpp.jpmchase.net:8090/Credit_Policy/Credit_History/Credit_Bureau_Reports_Prime.htm#Non-Traditional_Credit_Report) below.

**In-File Credit Reports**

Lending accepts in-file credit reports from three major credit-reporting repositories when they can report credit and public record information for each locality in which the borrower has lived during the last two years. Lending Book also accepts in-file reports from less than three credit-reporting repositories if that is the extent of the data available for the borrower.

In-file credit reports must identify the repository's source for each specific tradeline.

**Alert**: A joint or combined report for a married couple must contain all debts of both parties. Otherwise, obtain separate reports.

**Merged Credit Reports**

Lending accepts an automated merged credit report that electronically combines the information from the in-file credit reports from three different repositories into a single report, as long as an independent reporting agency provides the merged report. Lending only accepts a merged report that combines the in-file credit reports from two different repositories if that is the extent of the data available for the borrower.

An automated merged credit report must clearly reflect all this information:

* All of the information from the three (or two, if applicable) in-file credit reports, (a two-bureau merged in-file report must reflect that Lending initially ordered a three bureau in-file report)
* The names of the repositories the agency used to provide  the information for the report
* All duplicate information (that which is not exactly the same on each report), or the most derogatory of the duplicate information that pertains to payment history and/or current payment status

**Alert**: A joint or combined report for a married couple must contain all debts of both parties. Otherwise, obtain separate reports.

**Residential Mortgage Credit Report (RMCR)**

A consumer-reporting agency prepares a Residential Mortgage Credit Report (RMCR) for an individual borrower or for two borrowers who are married to each other. The agency merges and verifies credit information from a minimum of two major repositories before sending it to the user. The report provides current, verified, detailed information on the borrower's credit, employment, residence, and public record history.

The reporting agency verifies and reports all this borrower information:

* Current employment and income
* Employment history for a minimum of two previous years
* Residence history
* All debts listed on the application (including terms, balances, payment history, and ratings)
* All available legal information discovered by a search of public records (including lawsuits, judgments, foreclosures, garnishments, bankruptcies, and divorces).

**Alert**: A joint or combined report for a married couple must contain all debts of both parties. Otherwise, obtain separate reports.

**Non-traditional Credit Reports**

If the credit-reporting repositories or credit-reporting agencies are unable to develop an RMCR on a borrower, obtain a non-traditional mortgage credit report when product and program guidelines permit.

See [Limited Credit](http://mbpp.jpmchase.net:8090/Credit_Policy/Credit_History/Limited_Credit.htm) for detailed information on non-traditional credit reports.

**Credit Bureau Report Requirements for Community Property States**

In community property states, when a married individual applies for credit using sole and separate property, this complicates the credit history review.

Except when state law permits, do not run credit on the non-applicant spouse. Exclude the sole and separate income, assets, liabilities, and debts of the non-applicant spouse from consideration when qualifying the applicant spouse.

For further clarification on community property issues, contact Legal and Compliance, or Operations Management

**Credit Bureau Risk Scores**

**Overview**

Credit risk scores provide Lending with the relative probability of borrower default on a loan request. The mortgage industry uses the industry-standard credit risk scores (aka FICO scores) developed by the Fair Isaac Corporation (FICO), which have proven statistically to be valuable tools in predicting relative loan performance over time.

The credit risk scores used by the three major credit-reporting repositories (Equifax, TransUnion, and Experian) produce a numeric value that represents the relative odds that an extended loan will go into default. The higher the credit risk score, the less likely it is that the borrower will default.

The three major credit-reporting repositories work with FICO to develop a FICO score specific to the repository. Because of variances in how and when the credit-reporting repositories receive creditor information, and differences in creditors that report to the repositories (i.e., not all creditors report to all three bureaus), the repositories and FICO build, monitor, maintain, and update specific credit risk scorecards.

These are the repositories and the associated credit risk score trade names:

|  |  |
| --- | --- |
| **Repository** | **Risk Score Trade Name** |
| Equifax | Beacon |
| TransUnion | Classic 04 |
| Experian | FICO |

**Obtaining a Credit Risk Score**

When obtaining a credit risk score:

* Request a score for each borrower, regardless of the borrower's employment status.
* Obtain a score from each repository used in the compilation of the credit report data, regardless of the type of credit report obtained.

The credit report documentation requirement may vary based on the loan product, documentation program, and LTV.

**Credit Risk Score Selection**

After ordering and receiving a credit report, select a single "representative" credit risk score from the scores on the report (or reports, if more than one) as follows:

|  |  |
| --- | --- |
| **IF...** | **THEN use...** |
| the report contains three (3) credit risk scores, | the middle score for each borrower. |
| the report contains two (2) credit risk scores, | the lowest score for each borrower. |
| the report contains one (1) credit risk score, | that score. |
| multiple borrowers are applying, | the lowest score after determining the scores for all borrowers based on the above. |
| a single repository reports more than one (1) credit risk score, | the first score listed of the multiple scores as "the score" for **that repository only**. |

This is the score to use when determining the loan product and program parameters.

**Score Reason Codes**

Each repository produces a credit risk score, as well as the score reason codes that reduced the score from a theoretical "perfect" score.

These reason codes differ from one repository to another because of variations in the data the repository reports and uses to generate the credit risk score. Underwriting must use the score reason codes associated with the chosen representative credit score.

**Adverse Action and Credit Risk Scores**

When an individual product or program requires a minimum credit risk score and results in an adverse determination because the score is less than that minimum, the adverse action reasons correspond to the score factors contributing to the low score.

**Credit Requirements and Analysis**

**Overview**

Reported credit bureau information is the primary measurement of the borrower's credit history; Lending Book must analyze it carefully to determine if the borrower demonstrates reliability and responsibility in the repayment of obligations.

Follow all Automated Underwriting (AU) guidance and messaging.

Although AU decisions provide guidance and messaging, this topic provides further instructions on how to analyze a credit report for all loan requests. If a manual underwrite is necessary, follow the additional guidance in this topic.

**Credit History Basic Requirements**

To qualify for any loan with Underwriting Institute, the borrower must have a satisfactory repayment history. Lending Book does not consider this a compensating factor that offsets weaknesses in other areas of the borrower's credit profile.

The borrower's credit history generally should reflect the following:

* No history of bankruptcy
* No history of foreclosure
* A history of meeting payments according to the terms and conditions of the credit obligation
* A sufficient history to establish a favorable repayment pattern
* Minimum tradeline requirements, as outlined below

**Minimum Tradeline Requirements**

The borrower must meet these minimum tradeline requirements for Lending Book to consider their loan request:

|  |  |  |
| --- | --- | --- |
| **File Type** | **Requirements** | **Additional Information** |
| Thick file | The credit file must have both of these for each borrower:   * Minimum of three active tradelines with 12 months of satisfactory history on each**1** * Minimum Credit history of 24 months | Files not meeting these requirements are "Thin files." |
| Thin file | The loan transaction must have, at a minimum, all of these:   * Compensating factors * Four supplemental non-traditional credit references with 12 months of satisfactory history for each   In addition, a supervisor or manager must review, document, and approve the file. | See Limited Credit/Non-Traditional Credit Requirements for more information. |

**1** Lending Book defines active as the last activity date less than or equal to 12 months from the current date.

**Note**: Specific mortgage products, programs, or processing methods may require the use of specific credit history requirements.

**Credit Bureau Analysis for All Loans**

For all loans, Lending Book requires review of the following aspects of the credit bureau report in addition to following any AU system messaging:

|  |  |
| --- | --- |
| **Item** | **Requirement** |
| Bankruptcy or Foreclosure | Employees must determine whether the credit bureau report, application, or other documentation in the file discloses or reports bankruptcy or foreclosure. See Derogatory Credit for additional guidance. |
| Credit Risk Score | The selected credit risk score must be accurate. See Credit Bureau Risk Scores for additional guidance. |
| Fraud Alert | The credit bureau report must contain evidence that the AUS has run one of the fraud alert programs.  An in-file credit report must supplement a credit report received from a referral source (e.g., broker or correspondent) when the loan was underwritten manually and the credit report does not include a Fraud Alert. |
| Identity Theft Red Flags | To combat fraud and identity theft, employees must recognize potential red flags during review of the credit bureau report and know what to do when a potential red flag exists.  Red flags include, but are not limited to:   * Fraud or active duty alert * Credit freeze * Report of address discrepancy * Recent and significant increase in the volume of inquiries * Unusual number of recently established credit relationships * Material change in the use of credit, especially with respect to recently established credit relationships * Account a financial institution or creditor closed for cause or identified for abuse of account privileges   **Alert**: Due to rising occurrences of identity theft and fraud, Lending Book does not allow waivers of loan conditions related to identification documentation. |
| Inquiries | Employees must determine if numerous inquiries reported on the credit bureau report require an explanation from the borrower and/or an investigation to discover if any new credit obligations resulted from the inquiries.  The borrower must provide a letter of explanation for inquiries less than 120 days old when credit report or mortgage application does not reflect a corresponding tradeline.  Inquiries with a corresponding trade line on the credit report or mortgage application do not require a letter of explanation.  If credit resulted from the inquiry, verify it and include the obligation in the qualifying debt ratio calculation. |
| Undisclosed Debt | The borrower must explain any debts that they did not disclose on the application. Underwriting must report the debts on the approval document. Undisclosed debt may cause the debt ratio to exceed guidelines and could result in loan denial. |
| Unstated Derogatory/Delinquent Credit Bureau Amounts | If the credit bureau report does not state a balance for charge-offs, judgments, or collection accounts, obtain and document the balance. |

**Credit Bureau Analysis for Manually Underwritten Loans**

These are some situations that may require manual underwriting:

* Specific loan products or programs
* No credit scores / Out of Scope loans (not due to derogatory credit)
* Serious derogatory credit events
* Errors on credit report (aka disputed derogatory credit)
* Thin Files

For manually underwritten loans, the reviewer must analyze the credit bureau report for the following information in addition to following any AU messaging:

|  |  |
| --- | --- |
| **Item** | **Requirement** |
| Adverse Trends | Require and review a letter of explanation from the borrower to support the reasons behind any adverse trends. Consider and weigh the reasons provided by the borrower. Document any offsetting compensating factors to negative trends including, but not limited to:   * Delinquency * Significant new liabilities * Judgments * Collections   See Derogatory Credit for additional guidance. |
| Borrower Profile | To identify potential risk, carefully analyze the full borrower profile including, but not limited to:   * The type (installment or revolving) and amount of outstanding credit * Age of accounts * Balance to account limit ratios * Recent changes in the number of open accounts or overall amount of credit outstanding * Recent inquires shown on credit report * Payment history of all accounts * Credit Risk Score Reason Factors * Transaction characteristics * Collateral aspects |
| Payment History | Determine the borrower's willingness to repay. Review of payment history as well as other items on the credit bureau report for indications of the borrower's willingness to repay (collection accounts, charge-offs, judgments, liens, tax liens, bankruptcy, foreclosure, forgiveness of debt).  If the Borrower's credit history includes both tradelines and noncredit payment references, place more weight on the tradelines. In addition, do not use noncredit payment references to offset derogatory credit.  If the borrower's credit history includes housing obligations, place more weight on how the borrower made housing payments as opposed to non-housing payments, but do not ignore any derogatory information in the credit history.  Weigh any derogatory information against the rest of the credit history to decide whether it is significant. In making the determination, do not ignore any derogatory credit; however, give more weight to late housing payments and to derogatory information or late payments occurring within the past two (2) years. Generally, the more recent the adverse or derogatory credit information, the more likely it is significant.  These are some aspects to consider:   * The number, timing and extent of the adverse or derogatory credit information * The number, type and size of accounts with adverse or derogatory credit information * Public record information, such as judgments and collection accounts |
| Score Less Than Minimum Required | Credit risk scores lower than product or program minimum requirements are exceptions to policy; therefore, compensating factors must offset them. Compensating factors and/or extenuating circumstances may offset a lower score when no additional layering of risk exists. In all cases, the reviewer must document any offsetting compensating factors to negative trends. See Derogatory Credit for additional guidance.  Manager or Exceptions Desk approval may be necessary.  For more information, see Exceptions. |
| Score Reason Factors | Analyze the score factors used in calculating the score. Compare those codes with data on the credit report to identify if any adverse trends exist, such as the accumulation of debts as they provide meaningful insight into primary risk factors behind the credit risk score.  Although borrowers with low credit scores represent a relatively small percentage of all applicants, findings validate that they account for a disproportionate percentage of eventual default.  View low scores as a strong indication that the borrower's credit reputation may not be acceptable. |
| Serious Derogatory Credit | Adverse credit information in and of itself does not mean the Borrower's credit reputation is unacceptable. When there is adverse or derogatory information in the Borrower's credit history, it must be determined whether the derogatory information is significant.  Although many situations involving derogatory credit information may be unclear, especially when they involve disputes about obligations, Lending Book generally does not consider the derogatory credit information significant when it consists only of isolated late payments, even if several accounts show sporadic late payments, provided all of these conditions exist:   * The late payments were not recent * The late payments did not extend beyond one month * The number and size of delinquent accounts is not large in relation to the overall credit * The credit history does not show multiple revolving accounts with high balances-to-limits or high overall utilization of revolving credit * The borrower has paid all other credit as agreed   To consider a borrower with any serious derogatory credit, or a credit score less than product or program minimum requirements, the transaction must meet additional guidelines found in the Derogatory Credit topic. |
| Tradelines | Confirm the borrower(s) meet the minimum tradeline requirements above. |
| Unstated Derogatory/ Delinquent Credit Bureau Amounts | If the credit bureau report does not state a balance for charge-offs, judgments, or collection accounts, obtain and document the balance. |
| Layering of Risk | Consider the layering of risk when evaluating the borrower's credit reputation. Require a stronger credit reputation if capacity or collateral is weak. |

**Other Credit Review Considerations**

**Also Known As (AKA)**

Request credit bureau reports when the applicant discloses, or the file otherwise notes AKAs (Also Known As). Review them appropriately according to the assigned credit risk score and review level.

**Authorized User**

When a creditor allows an "Authorized User," they give permission to the obligor on the account to allow a spouse or other designated person to make charges to the account. Generally, the authorized user is not under contractual obligation to repay, unless the creditor or state law requires repayment under specific terms.

When evaluating credit worthiness, Lending Book employees must consider accounts that the borrower (either individually or jointly with another party) is obligated to pay by contractual arrangement with a creditor.

Additionally, consider other accounts where the borrower is a permitted user or non-obligor on a spousal or ex-spousal account when evaluating the borrower(s)' creditworthiness under the specific circumstances outlined below.

In some circumstances, a borrower may be an authorized user only on a revolving account. If the authorized user is not a spouse or former spouse, at the borrower's request, Lending Book will consider the account in the evaluation, provided the borrower can provide evidence that he or she has been paying the debt.

|  |  |  |  |
| --- | --- | --- | --- |
| **IF the authorized borrower is a...** | **AND...** | **AND...** | **THEN...** |
| * spouse, or * former spouse | the borrower requests that Lending Book consider an account in the name of the borrower's spouse or former spouse when evaluating their loan, | the credit report or direct verification has verified the account, | include the payment in the debt ratio and use the account(s) to help develop a credit history when  the borrower has a thin file. |
| non-spouse | the borrower requests that Lending Book consider an account in the name of another party when evaluating their loan, | the borrower can evidence that they have been paying the debt for the preceding 12 months, | include the payment in the debt ratio and use the account(s) to help develop a credit history when the borrower has a thin file. |
| * spouse, * former spouse, or * non-spouse | the borrower indicates they are not responsible for the payment, | the credit report verifies that the borrower is an "authorized user" only, | exclude the payment from the debt-to-income ratio and do not consider the payment history in the loan analysis. |

**Defendant in a Lawsuit**

Borrowers involved as defendants in a lawsuit with pending litigation may not be eligible for extension of credit. To determine the borrower's eligibility, the borrower's attorney must provide a letter explaining the lawsuit with supporting documentation. Give careful consideration to these factors:

* Determine the impact of the lawsuit on the borrower's ability to repay the mortgage if it levies additional financial obligations against the borrower.
* Analyze supporting documentation to determine the extent of potential income or asset interruption.
* Determine whether an insurance policy or established escrow fund will cover the potential obligation.
* Determine whether the title company will take exception to the pending litigation and decline to insure our first lien position.
* When the amount of the potential obligation is minimal (less than $10,000), determine whether the borrower has sufficient assets to establish an escrow account for 1.5 times the amount of the proposed damages. The attorney representing the borrower in the litigation must hold the assets.

**Title and Lien Position**

Regardless of the level of review indicated, the borrower must pay in full and clear any item that may impact either of these:

* Title of the subject property
* Lien position of the Lending Book extended first or second mortgage

Sufficient funds to pay any such amounts must be available to the borrower from cash, cash-like assets, or loan proceeds. Account for such funds in reserve calculations and requirements.

**Treatment of Medical Information**

Medical information can be in any form or medium (paper, electronic, spoken, etc.) and can be provided directly or indirectly. Never solicit information regarding the nature of illness or disability, course of treatment, or the future health expectations of the individual related to incursion of the debt. Any medical information, even if unsolicited, should not result in any less favorable treatment than any other credit information.

**Derogatory Credit**

**Overview**

Derogatory credit is an obligation(s) that has not been repaid according to original terms. It may be reflected in the delinquent manner in which a borrower repays the obligation or in how the borrower is relieved of the debt through legal recourse by the creditor.

The manner in which the borrower(s) have managed their previous credit is a strong indicator of future performance. A history of derogatory credit and / or an instance of a major derogatory credit item increases the risk associated with the loan request.

For these reasons, all derogatory credit occurrences, including more recent occurrences not listed on a credit report, must be carefully considered in the analysis of the loan request.

**Note**: Although Automated Underwriting (AU) decisions provide guidance and messaging which must be followed on all loan requests, this topic helps the analyst identify derogatory credit and the associated actions to take in specific situations. If a manual underwrite is required, follow the additional guidance provided in this topic.

**Policy**

The following list of occurrences indicates areas of a borrower(s)' credit history that are defined as serious derogatory credit, regardless of the credit risk score, and requires a thorough review.

For consideration, a loan request from borrowers with serious derogatory credit history must meet all the guidelines detailed below and provide:

* Satisfactory written explanation accompanied by supporting documentation, and
* Compensating factors to offset the layers of risk. See Exceptions for information on compensating factors.

**Serious Derogatory Items (disclosed or reported):**

* Bankruptcy
  + Chapter 7
  + Chapter 11
  + Chapter 12
  + Chapter 13
* Foreclosure
* Deed-in-Lieu of Foreclosure
* Forgiveness of Debt
  + Short Sale
  + Short Payoff
  + Modification (which included principal forgiveness)
* Collection account in excess of $1,000 within the last 24 months
* Charge-off in excess of $1,000 within the last 24 months
* Judgment in excess of $1,000 within the last 24 months
* Tax lien in excess of $1,000 within the last 24 months
* Repossession within the last 24 months
* Consumer Credit Counseling
* Mortgage Delinquency / Housing Debt
  + Any payment 30 days or more past due for any housing debt within the last 12 months

**Note**: Refer to the Mortgage/Housing Payment History section for additional requirements.

**Alert**: For additional information regarding the requirements for payoffs of delinquent credit accounts, refer to the Payoff of Liens and Delinquent Credit Accounts section below.

**Mortgage/Housing Payment History**

It is generally necessary to verify the applicant's primary housing payment history, if the applicant has rented or owned a primary residence in the most recent 24 months.

The borrower's payment history is considered to be unacceptable if, on any mortgage or primary housing debt, any of the following apply:

* Two or more 30 day delinquencies in the past 12 months;
* One or more 60 PLUS delinquency (60 or greater days delinquent) in the past 12 months;
* Three or more 30 day delinquencies in the past 24 months;
* Two or more 60 day delinquencies in the past 24 months;
* One or more 90 PLUS delinquency (90 or greater days delinquent) the past 24 months.

**Alert:** Home Equity Lines of Credit (HELOCs) are often reported as Revolving Lines or Unsecured Lines on credit bureau reports. Any Revolving Line or Unsecured line in the amount of $50,000 or more with a repayment term of more than or equal to 120 months shall be considered a mortgage trade line for credit review purposes (unless documentation is in file to indicate otherwise).

**Consumer Credit Counseling/Debt Management**

A borrower who experiences credit or financial management problems may elect to participate in consumer counseling sessions to learn how to correct or avoid such credit problems in the future. However, regardless of participation in the program, it is the borrower's current credit history that is of primary importance in the overall evaluation. Additionally, all re-established credit must be current.

Even when there is an acceptable Automated Underwriting System (AUS) response, the presence of Consumer Credit Counseling necessitates the need for Underwriting to perform an appropriate level of due diligence in reviewing the borrower’s overall credit profile and to evaluate the Consumer Credit Counseling utilized by the borrower to determine if the Consumer Credit Counseling is a positive or negative risk factor.

There are two types of consumer credit counseling:

* Homebuyer Education - designed to help first time homebuyers prepare for the financial responsibilities of homeownership.
  + If the borrower has an acceptable history of managing credit and has participated in counseling to prepare for homeownership, this should be considered a positive risk factor.
* Credit Mismanagement – designed to assist borrowers who have had problems managing their debts.  If the credit report shows the borrower
  + Has completed the counseling and has re-established acceptable credit by repaying the creditors directly, the loan may be considered a positive risk factor.
  + Is currently in credit counseling due to debt mismanagement and has not re-established acceptable credit, the loan is not an acceptable risk.

**Disputed Derogatory Credit**

In some circumstances, the borrower may be disputing the reported derogatory credit occurrence with the creditor. In those cases, to verify there is a dispute, the borrower must provide documentation such as:

* Legal documents,
* Contractual documents,
* Insurance papers, or
* Correspondence between the parties.

If an Automated Underwriting System (AUS) provides an approval with the inclusion of the disputed derogatory credit item(s), the AUS findings will indicate if further action is necessary. If an AUS approval is not received and/or the approval terms were affected by the disputed credit, follow the below guidance.

**Non-Agency loans:**

* The loan must be manually reviewed and decisioned without the use of the borrower(s)' credit scores (and taking the disputed derogatory item(s) into consideration), or
* Resolution to the disputed item is required and a new credit report confirming the resolution must be obtained.

**Agency loans:**

* Resolution to the disputed item is required and a new credit report confirming the resolution must be obtained. A manual underwrite is not permitted.

Underwriting must:

* Evaluate the impact the disputed derogatory credit item may have on the borrower(s)’ ability to manage the mortgage debt and how other debts have been managed in the past.
* Take into consideration the equity investment in the property, amount of the disputed credit item, the borrower's asset position, credit risk score, and repayment history with respect to other debts.

**Note:** If these areas are acceptable, the serious or major derogatory credit may be considered an isolated incident, with no material impact in the underwriting analysis.

**Serious Derogatory Event Seasoning Requirements**

Select credit events that generate severe negative impact to a borrower's credit history are defined as serious derogatory credit, and these events must reach minimum seasoning requirements (waiting period) since completion as illustrated in the following table.

|  |  |  |
| --- | --- | --- |
| **Serious Derogatory Event** | **Seasoning Requirement - Months since Event Completion** | |
| **If due to Extenuating Circumstances** | **If due to Financial Mismanagement** |
| Single Bankruptcy   * Chapter   7 * Chapter 11 * Chapter 12 * Chapter 13 | 24 | 48 |
| Multiple Bankruptcy Filings**3**  (Same Borrower)   * Chapter   7 * Chapter 11 * Chapter 12 * Chapter 13 | 36 | 60 |
| Foreclosure | 36 Months:   * With max. 90% LTV/CLTV**1** **and** * Purchase of Primary Residence **or** * No Cash-out Refinance (all property types)   84 Months:   * If Max. LTV/CLTV**1** is greater than 90% **or** * Purchase of Second Home or Non Owner Occupied Property **or** * Cash-out Refinance | 84 Months    **Note:** 84 Months Seasoning Required Regardless of AUS Decision |
| Deed-in-Lieu of Foreclosure | 36 Months:   * With max. 90% LTV/CLTV**1** **and** * Purchase of Primary Residence **or** * No Cash-out Refinance (all property types)   84 Months:   * If Max. LTV/CLTV**1** is greater than 90% **or** * Purchase of Second Home or Non Owner Occupied Property **or** * Cash-out Refinance | * 48 – with max. 90% LTV/CLTV**1** * 84 – greater than 90% LTV/CLTV**1** |
| **Forgiveness of Debt** **2** | | |
| Short Sale | 36 Months:   * With max. 90% LTV/CLTV**1** **and** * Purchase of Primary Residence **or** * No Cash-out Refinance (all property types)   84 Months:   * If Max. LTV/CLTV**1** is greater than 90% **or** * Purchase of Second Home or Non Owner Occupied Property **or** * Cash-out Refinance | * 48 – with max. 90% LTV/CLTV**1** * 84 – greater than 90% LTV/CLTV**1** |
| Short Payoff | 36 Months:   * With max. 90% LTV/CLTV**1** **and** * Purchase of Primary Residence **or** * No Cash-out Refinance (all property types)   84 Months:   * If Max. LTV/CLTV**1** is greater than 90% **or** * Purchase of Second Home or Non Owner Occupied Property **or** * Cash-out Refinance | * 48 – with max. 90% LTV/CLTV**1** * 84 – greater than 90% LTV/CLTV**1** |
| Modification (which included principal forgiveness) | 36 | 48 |

**1**Important Note: LTV/CLTV limits in the above chart are for Derogatory Credit Policy purposes only and are not reflective of actual allowable limits of any specific product or program.  Please see applicable Product Guide for maximum allowable LTV/CLTV limits.

**2**The new loan must not be contingent on a concurrent Forgiveness of Debt transaction

**3**See Multiple Bankruptcy Filings Section (below) for more information and requirements.

**Note:** In addition to the above seasoning requirements, the borrower is also subject to the Requirements for Re-establishing Credit as reflected below within this topic.

**HARP - Refi Plus and Relief Refinance Derogatory Credit**

The seasoning requirements for serious derogatory events detailed above do not apply to the FNMA Refi Plus and the FHLMC Relief Refi products.

In addition, Delinquent/Past-Due accounts do not need to be brought current or satisfied except as follows:

* Any derogatory credit item impacting title and/or Underwriting Institute’s lien position must be satisfied or the lien must be subordinated to the new Underwriting Institute Mortgage and the title company must insure our first lien position.

See the HARP Fannie Mae Refi Plus and HARP Freddie Mac Relief Refi Underwriting Specs for additional information.

**Completion Date Definition**

The definition of completion date varies based on the event type. Please refer to the table below for completion dates.

|  |  |
| --- | --- |
| **Event** | **Completion Date** |
| Bankruptcy | Discharge or Dismissal Date |
| Foreclosure, Deed-in-Lieu of Foreclosure | Transaction completion date |
| Forgiveness of Debt (Short Sale) | Sale Date |
| Forgiveness of Debt (Short Payoff or Modification) | Transaction Completion Date |

**Extenuating Circumstances**

Extenuating circumstances are isolated nonrecurring events that are beyond the borrower’s control that result in a sudden, significant, and prolonged reduction in income or a catastrophic increase in financial obligations which rendered the Borrower unable to repay as agreed.

See the Extenuating Circumstances topic in the Lender Underwriting Policy for additional information, including documentation requirements and detailed calculation methods.

Follow the guidelines below when any of the following events were a result of extenuating circumstances:

* Chapter 13 Bankruptcy (regardless of the reason for the filing);
* Chapter 7, 11, or 12 Bankruptcy,
* Foreclosure,
* Deed-in-Lieu of Foreclosure, or
* Forgiveness of Debt: Short Sale, Short-Payoff, or Modification of a mortgage

The guidelines below must be met for the circumstances outlined above:

* The borrower must provide a letter of explanation and documentation evidencing the derogatory credit incident was not due to financial mismanagement, but was the result of extenuating circumstances beyond their control.
* The borrower must provide copies of full documentation verifying completion (e.g., bankruptcy petition and discharge papers and list of creditors) when Underwriting is unable to determine the completion date on the credit bureau or when required by specific guidelines.
* Underwriting must review all aspects of the file that evidence the borrower's recovery from the circumstance to determine that the circumstances and events leading to the incident are not likely to recur.
* The file must be documented with evidence that the borrower had an acceptable credit history prior to the extenuating circumstances, and
* Underwriting must have sufficient documentation to support their conclusion that:
  + The borrower is now creditworthy,
  + The borrower has the capacity to repay the obligation, and
  + There is no additional or potential overlaying of risks.
* The borrower must meet the criteria contained within the Requirements for Re-establishing Credit Section of this topic.

**Financial Mismanagement**

Guidelines are provided below for extenuating circumstances that cannot be documented or supported, including any of the following that were a result of financial mismanagement (rather than extenuating circumstances):

* Chapter 13 Bankruptcy (regardless of the reason for the filing),
* Chapter 7, 11, or 12 Bankruptcy,
* Foreclosure,
* Deed-in-Lieu of Foreclosure, or
* Forgiveness of Debt: Short Sale, Short-Payoff, or Modification of a mortgage

The guidelines below must be met for the circumstances outlined above:

* The borrower must provide a letter of explanation.
* The borrower must provide copies of full documentation verifying completion (e.g., bankruptcy petition and discharge papers and list of creditors) when Underwriting is unable to determine the completion date on the credit bureau or when required by specific guidelines.
* Underwriting must review all aspects of the file that evidence the borrower's recovery from the circumstance to determine that the circumstances and events leading to the event are not likely to recur.
* Underwriting must review all aspects of the file paying particular attention to risk score factor reason codes that accompany the credit risk score, notably:
  + Inquiries,
  + Age of accounts,
  + Balance-to-limits, and
  + Any adverse or derogatory information.

Underwriting must have sufficient documentation to support their conclusion that:

* + The borrower is now creditworthy,
  + The borrower has the capacity to repay the obligation, and
  + There is no additional or potential overlaying of risks.

The borrower must meet the criteria contained within the Requirements for Re-establishing Credit Section of this topic.

**Requirements for Re-establishing Credit:**

* All re-established credit must be current;
* Borrower(s) must have re-established credit for a minimum length of time equivalent to at least the Derogatory Credit Event’s Seasoning Requirements (Waiting Period) as reflected in this Credit Policy topic and should be "like" sources of previous credit;
* A minimum of 4 tradelines are required, of which at least one must be a traditional source of credit and one rating must be housing related. If housing related debt is not reported on the credit report, provide evidence to support timely payments (i.e., canceled checks, money orders, bank statements);
* No new public records (e.g., foreclosure, unpaid judgments, collections, liens, garnishments);
* No more than two 30 days past due notices in the last 2 years on installment or revolving lines;
* No 60-day past due notices since the date of event completion;
* No late payments on housing since the date of event completion;
* The borrower(s)’ credit history should reflect evidence of stability and control in the use, management, and repayment of credit obligations.

**Multiple Bankruptcy Filings**

For a borrower with more than one bankruptcy filing within the past seven years, a five-year waiting period is required, measured from the most recent dismissal or discharge date.

**Note:** Two or more borrowers with individual bankruptcies are not cumulative, and do not constitute multiple bankruptcies. For example, if the borrower has one bankruptcy and the co-borrower has one bankruptcy this is not considered a multiple bankruptcy.

*Exceptions for Extenuating Circumstances*

A three-year waiting period is permitted if extenuating circumstances can be documented, and is measured from the most recent bankruptcy discharge or dismissal date. The most recent bankruptcy filing must have been the result of extenuating circumstances.

**Payoff of Liens and Delinquent Credit Accounts**

**All Agency & Non Agency Loan Products**

Certain accounts that reflect past due balances or reported as delinquent credit may be required to be paid off or brought current. Use the following chart to help determine the requirements:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | | **Streamline HARP (Refi Plus/Relief Refi)** | **Non-Streamline HARP (DU Refi Plus & LP Open Access)** | **Non-HARP**  **Agency/Non-Agency** | |
| **Accounts** | **Accounts** | **Accounts** | **Accounts3** |
| **Follow AUS Findings?** | | **N/A** | **Yes** | **Yes** | **No** |
| **Account Type** | **Property**  **Type/Occupancy** | **Require Payoff/Brought Current**    **Yes/No** | | | |
| **Charge Offs & Collections** | | | | | |
| Any amount: | 1 Unit Primary Residences | No**1** | AUS | No**1** | Yes |
| Individual OR Total balance of all accounts is greater than $5,000**2** | 2-4 Unit Primary Residences & Second Homes | No**1** | AUS | Yes | Yes |
| Individual OR Total balance of all accounts is less than or equal to $5,000 | 2-4 Unit Primary Residences & Second Homes | No**1** | AUS | No**1** | Yes |
| Individual account greater than or equal to $250 OR Total balance of all accounts is greater than $1,000**2** | Non Owner Occupied | No**1** | AUS | Yes | Yes |
| Individual account less than $250 OR Total balance of all accounts is less than or equal to $1,000**2** | Non Owner Occupied | No**1** | AUS | No**1** | Yes |
| Garnishments: Regardless of amount | All | No**1** | AUS | Yes | Yes |
| IRS/Federal/State/Local (city/county) Tax Liens**4** | All | Yes | Yes | Yes | Yes |
| Judgments: Regardless of amount | All | No**1** | AUS | Yes | Yes |
| Liens (other): Regardless of amount**4** | All | Yes | Yes | Yes | Yes |
| Past Due Accounts: Any Type regardless of amount | All | No**1** | AUS | Yes | Yes |
| Tax Liens: Regardless of amount**4** | All | Yes | Yes | Yes | Yes |
| Property Tax Liens (Subject Property) regardless of amount**4** | All | Yes | Yes | Yes | Yes |
| Property Tax Liens (Non-Subject Property) regardless of amount | All | No**1** | No**1** | No**1** | Yes |

**1**These accounts will only require payoff if the title company will not insure Underwriting Institute’s first lien position on the subject property.

**2**If either individual or total limits are exceeded, all collection & charge-off accounts must be paid in full at or prior to closing, unless otherwise noted in the table above.

**3**For all products and programs, any delinquent/past due Underwriting Institute accounts must be brought current or satisfied prior to or at closing, regardless of AUS decision.

**4**To protect the Lender first lien position against current or future claims, these liens will be required to be paid off. In addition, Lender must receive acceptable documentation from (as issued by) the creditor or the Federal/State or local Municipality to confirm lien satisfaction. If the debt will be paid off at time of closing, it must be reflected on the HUD 1 Settlement Statement.

In addition to the requirements reflected in the above chart:

* The borrower must pay in full and clear any derogatory item as outlined in this Policy and any derogatory item that is revealed as an exception on our title commitment.

When an account is required to be brought current or paid in full, the borrower must have sufficient funds to pay any such amounts from cash/cash like assets, or loan proceeds, and the use of those funds must be deducted from reserve calculations and requirements.

**Automated Underwriting Approvals**

**Bankruptcy and Foreclosure**

If the loan with a Bankruptcy or Foreclosure has been approved by an Automated Underwriting System (AUS) (Internal AUS, DU, or LP), the following conditions must be met:

* Condition 1: The Bankruptcy or Foreclosure has been recognized by the AUS as evidenced by response findings statement or messages; and,
* Condition 2: Any additional documentation required by the AUS response findings statement or messages must be followed.

If the conditions above cannot be met, follow the additional documentation requirements listed under:

* Extenuating Circumstances, or
* Financial Mismanagement, and
* Requirements for Re-establishing Credit in Extenuating Circumstances and [Financial Mismanagement](http://mbpp.jpmchase.net:8090/Credit_Policy/Credit_History/Deragotory_Credit_Prime.htm#Financial_Mismanagement) sections above.

**Forgiveness of Debt**

If the loan has been approved by an Automated Underwriting System (AUS) (Internal AUS, DU or LP) for a borrower with history or incident of Forgiveness of Debt, the more restrictive of the requirements contained in the response findings or messages, and the requirements contained within this Policy must be followed, **regardless of AUS decision**.

**Manual Underwriting and Derogatory Credit**

Certain credit factors including situations involving derogatory credit may trigger the need for a manual underwrite. Please see Credit Bureau Analysis for Manually Underwritten Loans in this guide for additional details and review requirements.

**Limited Credit**

**Overview**

A borrower with a limited credit history (aka "thin file") or no credit history may be considered if a reasonable and satisfactory credit history can be documented. A reasonable credit history can be established by obtaining Non-Traditional verifications or a hybrid of traditional and Non-Traditional credit references.

Non-Traditional sources cannot be used to offset negative credit history, only to support limited good credit.

**Alert:** Non-Traditional credit, where permitted by channel, must be submitted to obtain appropriate level of approval.

**Requirements**

If the borrower indicates at the time of application they have no credit or limited credit, information on Non-Traditional sources of credit must be obtained. If this applies to all borrowers on the loan transaction, then Homebuyer Education is required.

When using a hybrid of traditional and Non-Traditional credit references, or only non-traditional credit references:

|  |  |
| --- | --- |
| **IF a residential reference is...** | **THEN the required number of additional credit references that have been active and paid as agreed for at least 12 months is...** |
| available, | 3. |
| not available, | 4. |

Only credit arrangements that require the borrower to make periodic payments on a regular basis may be considered. When used to establish a minimum payment history, traditional and non-traditional credit references must:

* Have existed for at least 12 months, **and**
* Have been paid as agreed, **and**
* Appear on a credit report or be directly verified.

A documented savings history of at least 12 months may be included as one of the noncredit payment references if the history shows periodic deposits (at least quarterly) resulting in a growing balance over the year.

**Non-Traditional Mortgage Credit Report**

For borrowers with limited credit, a Non-Traditional Mortgage Credit Report (NMCR) aka Non-Traditional Mortgage Report (NTMR) is preferred on all programs/products when the credit repositories or credit reporting agencies are unable to develop a Residential Mortgage Credit Report (RMCR) on a borrower.

The NMCR is designed to be a substitute or supplement to the RMCR in those cases in which the borrower has insufficient or no credit references.

The NMCR cannot be used to offset a poor payment history reported on a traditional credit report.

The format of the NMCR is similar to that of a traditional credit report and will specify that it meets the required criteria..

The types of credit that can be used are categorized into three different tiers, which are ranked numerically by their importance. Payment references in consecutive order beginning with Level I should be used.

|  |  |
| --- | --- |
| **Level** | **Item** |
| Level I | * Rental/Housing * Electricity * Gas * Water * Telephone * Cable TV |
| Level II | Insurance premiums not payroll deducted, such as:   * Medical * Life * Automobile * Renters insurance |
| Level III | Miscellaneous accounts, such as:   * Childcare * Local grocer * Furniture or appliance stores * School tuition   Loans from individuals are acceptable if verified by:   * Written agreement and * Canceled checks |

Using a combination of traditional and Tier I non-traditional credit sources, the credit bureau will attempt to obtain a 12-month payment history on four to six sources.

Rental / housing payments will be verified by the bureau on the NMCR, when possible.

|  |  |  |
| --- | --- | --- |
| **IF rental/housing payments are made to a...** | **AND...** | **THEN...** |
| professional property management company, | a 12-month payment history is provided to the bureau, | no additional documentation is required. |
| party other than a professional property management company, | regardless of the history being reported on the credit report, | the borrower must provide:   * 12 months of canceled checks or bank statements to evidence timely payments, and * A copy of the lease.   If these documents are not available, public landlord-tenant records for court filings, judgments, or evictions (or dismissal of such action) must be checked for the last 24 months. The bureau will attempt to do this, or will retain a third party vendor who offers this service. |

If fewer than four credit references have been verified at this point, the agency will contact Tier II and Tier III sources. If the reporting agency is not able to collect sufficient information to prepare the NMCR, the credit information gathered will be provided to Lending Book for their evaluation of the borrower's credit worthiness and to obtain additional direct credit references as needed.

**Residence Reference**

**Overview**

Borrower(s) must list all residences for the last two years, for all transactions.

Note: Specific mortgage products, programs, or processing methods may require the use of a specific Residence Reference verification method.

**Mortgage Reference**

A satisfactory Verification of Mortgage payment history (VOM) is required for all mortgages secured by real estate owned by the borrower(s) during the past 12 months regardless of the borrower(s)’ credit score.

Payment history is verified by one of the following methods:

|  |  |
| --- | --- |
| **When...** | **Acceptable Method...** |
| the mortgage Note is held by a lender or mortgage servicer, | * Direct written VOM from the mortgagee or servicer, or * Review of the last 12 months payment history on the current credit bureau (or the entire mortgage history when open for < 12 months), or * Review of copies of canceled checks (front and back) for the last 12 months' payments. |
| the mortgage Note is held by a private individual, | * Review copies of canceled checks, or equivalent substitute, (front and back) for the last 12 months' payments, and * Copy of the note |

**Rental Reference**

A satisfactory Verification of Rent payment history (VOR) is required for all renters for the past 12 months regardless of the borrower's credit score.

Payment history is verified by one of the following methods:

|  |  |
| --- | --- |
| **When renting from...** | **Acceptable Method...** |
| a professional property management company, | * Direct written (VOR) from the management company that includes: * Rental amount * Payment history * Length of payment history * Landlord's contact information (name, address, and phone number) * Verification on an RMCR; the credit-reporting agency must verify rental history directly with the landlord's management agency. |
| an individual owner, | * Review copies of canceled checks, or equivalent substitute, (front and back) for the last 12 months' payments, and * Copy of the lease |

**Debt Analysis Guidelines**

**Debt-to-Income Ratio**

Lending Book requires calculation and analysis of  the debt-to-income (DTI) ratio, which establishes a borrower's capacity to service all monthly obligations based on representations and/or documentation, for all requests unless a specific program exempts it.

These guidelines provide standards, ensure uniform treatment of other debt instruments, and help Underwriting determine the borrower's recurring debt total.

The obligations which may need to be considered as recurring debts can be found via many sources, such as but not limited to: credit report, application, pay stubs, divorce decree and/or separation agreement.

Underwriting may request additional documentation verification, beyond the designated minimums, when the situation warrants it.

Debts for which the borrower is not the primary obligor but is instead an authorized user on another obligor's account may or may not be included in the borrower's recurring debt total. See the Authorized User section of the Credit Requirements and Analysis policy chapter for additional information.

**Note**: Specific product or program standards may differ; see the Product Guides in this manual for specific guidelines.

**Housing Debt (PITI)**

Determining the borrowers' debt-to-income ratio begins with calculating the proposed housing debt (aka principal, interest, taxes and insurance, or PITI) which includes:

* The proposed mortgage payment
* Real estate taxes not included in the mortgage payment
* Any insurance premiums (hazard, flood, and/or mortgage) not included in the mortgage payment
* Homeowner association fees
* Any home equity loan or HELOC payment(s), if applicable
* Any other special housing assessment fees

**Alimony, Child Support, and Separate Maintenance Payments**

Include alimony, child support, and separate maintenance payments, regardless of the number of monthly payments remaining, in the recurring debt total. Obtain and document file with verification that clearly defines the borrower's payment responsibility.

A copy of one of the following is an acceptable source:

* Divorce decree
* Signed separation agreement
* Notarized agreement signed by all parties and their respective attorney
* Court order
* Other legally accepted evidence dictated by local custom

**Note**: Consideration of alimony may differ for some products; see the specific product and program.

**Asset-secured Loans**

Exclude payments on loans secured by a borrower's liquid financial assets, such as life insurance policies, 401K/IRA accounts, CDs, stocks, bonds, marketable securities, etc., from the DTI when repayment of the loan rebuilds the financial asset, and the current verified balance in the account (or value of the financial asset) is sufficient to pay off the loan.

Always include payments on loans secured by real estate or other personal property in the DTI.

Obtain a copy of documentation showing all of the following:

* The asset used as collateral for the loan
* The interest rate and payment
* The loan amount
* The loan secured by the financial asset was made by a financial institution

For requirements on how to treat this liability type from an asset perspective, see Borrowed Funds - Secured in the "Asset Types" topic.

**Bridge Loans**

Include bridge loan payments in the borrower's DTI. If payments are not scheduled on a monthly basis, at a minimum, use monthly interest payments.

**Alert**: The bridge loan cannot be cross-collateralized on the Lending Book-financed property.

See Bridge Loans Proceeds in the "Asset Types" topic for requirements.

**Contractual Payments**

Underwriting must consider contractual obligations on certain investments or other business ventures (e.g., partnerships) that could impact the borrower's cash flow and debt service. Examples of obligations to consider that the credit bureau may not reflect, include, but are not limited to:

* Required capital contributions
* Negative capital account
* Loans to an owner or stockholder

**Co-signed Loan**

Include the outstanding balance of a co-signed loan as a contingent liability. Exclude the monthly payment on a non-mortgage related obligation from the qualifying DTI calculation if all of these conditions are met:

* The borrower is not the primary obligor on the co-signed loan.
* The primary obligor on the co-signed loan has a history of making payments and provides 12 months' canceled checks evidencing payment.
* The co-signed loan reflects a timely payment history.

**Note**: Mortgage or real estate secured obligations must be included in the DTI calculation unless the borrower has been released from liability by the creditor or the loan has been assigned by a court order. See Court-ordered Assignment of Debt topic below for additional information.

**Court-ordered Assignment of Debt**

Exclude an obligation (including a mortgage or real estate secured loan) assigned by a court order from the qualifying debt ratio calculation if all of these requirements are met:

* The borrower provides a copy of the court order, divorce decree or separation agreement, evidencing the assignment of the obligation to another party.
* Documentation is provided evidencing that the borrower has been removed from title (for a real estate secured obligation.)
* Payment history prior to the date of the assignment cannot be ignored.

**Credit Cards**

Use the payments and balances on the credit report for credit cards and revolving accounts:

If no payment amount appears on the credit report, include an estimated payment of 5% of the outstanding balance in the DTI.

If the credit report includes a borrower's business expense account, one of these is required:

|  |  |
| --- | --- |
| **IF business...** | **THEN...** |
| makes all payments, | obtain a statement from the employer that the company pays all business expenses. |
| does not make all payments, | include the monthly payment in the DTI. |

For open 30-day charge accounts with the total outstanding balance due monthly, the borrower must have verified liquid assets exceeding the balance and meeting the reserve requirements for the loan program.

|  |  |
| --- | --- |
| **IF sufficient liquid assets are...** | **THEN...** |
| verified, | exclude the reported monthly payment from the DTI. |
| not verified, | obtain evidence that the account has been paid in full and exclude the reported monthly payment from the DTI. |

**Alert**: Incorporate any revolving accounts listed on the application that are not on the credit bureau report into the analysis.

**Employee - Business Expenses**

Subtract from the borrower's qualifying income any business expenses that an employer does not reimburse, and average the amounts over the past two years, unless they are increasing. Find these expenses on:

* "Schedule A" (Form 1040 or Form 1040NR)
* Form 2106
* Form 2555 (Foreign Earned Income), or
* Other comparable Federal Tax form of the borrower's personal tax returns.

**Home Equity Lines of Credit (HELOC)**

Use the higher of the payment reported by the creditor on the CBR or 1% of the full line amount in the DTI.

See Subordinate Financing for additional Credit Policy requirements.

**Home Equity Loans**

Include any second mortgages with Underwriting Institute, or any other lender, financial or otherwise, in the DTI; use the actual loan payments.

**Alert**: Explain and justify any variance from this requirement in the approval document.

See Subordinate Financing for additional Credit Policy requirements.

**Installment Debt**

Include installment debt in the DTI regardless of the number of monthly payments remaining.

**Investment Gains and Losses**

Average and include any net recurring loss on a cash investment or an investment property as an expense in the DTI.

Include any net recurring cash gain as qualifying income, as appropriate.

**Lease Payments**

Include lease payments regardless of the remaining term because the borrower will be subject to either of these at the end of the lease term:

* A buyout of the lease (e.g., purchase of the car)
* A new lease obligation

**Non-Real Estate Lines of Credit, Balloon Loans and Interest-Only Loans**

Include verified monthly payments in the DTI, regardless of the number of payments remaining.

**Margin Debt**

Borrowers who have stock portfolios often have loans secured by the marketable securities in their brokerage accounts. Do not include the margin account in the DTI when all of these are true:

* The margin loan matches with a specific asset conversion.
* The approval document reports the margin loan separately.
* You subtract an amount equal to the margin loan balance from the borrower's marketable security total.
* You exclude an amount equal to the margin loan balance from the borrower's cash reserves and income calculations.

**Alert**: To properly reflect the borrower's net worth, report the excluded amount separately on the approval document as a non-liquid asset.

**Mortgage Debt**

Exercise prudent judgment in evaluating the debt service of first and second mortgage payments on all real estate holdings.

When a payment appears to be for interest-only or a below-market ARM, obtain a verification of mortgage or comparable alternate documentation to confirm whether the DTI calculation  includes adequate debt service.

**Payoff of Debt**

A borrower may wish to pay in full a debt reported on the application or credit report, and have that payment excluded from the qualifying parameters.

To pay the debt off prior to or at closing, and exclude the payment:

* Verify the borrower has the assets or sufficient equity to pay off the debt.
* Verify that the debt has been paid prior to, or at, closing.

**Note**: If the debt being paid-off is a revolving or open-end account, verify it has been closed.

**Reduction of Debt Balance (Paying Down a Balance)**

A borrower may choose to reduce the balance on a debt by paying a principal sum towards the balance. Regardless of the "paid-down" amount, or number of monthly payments remaining, consider the monthly payment a recurring obligation and include it in the qualifying DTI calculation.

**Relocation Benefits**

Eliminate the PITI on an existing residence from the debt-to-income ratio analysis when a borrower is relocating, and the loan file includes both of these:

* A copy of the offer to purchase the existing residence.
* At loan closing, a copy of the equity advance or a settlement statement evidences the sale and release from liability.

**Alert**: Any closing costs and points included in the relocation package are eligible for use as closing funds; however, the borrower must provide funds for prepaid items unless the relocation package specifically includes them.

See [Corporate Relocation](http://mbpp.jpmchase.net:8090/Credit_Policy/Employment/Corporate_Relocation.htm) for additional information.

**Sole-proprietor Debt**

For a sole proprietor, "business" debts are generally indistinguishable from personal debts. For example, sole proprietors may use automobiles as business vehicles and write off the corresponding debt as a business expense.

Because no corporate legal entity shields the borrower from having to pay this expense, include sole-proprietor business debts in the analysis.

The borrower's personal financial statement or 1003 application should reflect the outstanding balance(s) of the sole-proprietor's business debts. Address the business debt payments (principal and interest) as follows:

|  |  |
| --- | --- |
| **IF...** | **THEN...** |
| the borrower has not provided proof the business is paying the debt, | include the debt in the borrowers recurring monthly debt obligation. |
| evidence shows the business is paying the debt,  **Example**: The loan file includes all of these:   * A minimum of the most recent 12 months of canceled checks from the business checking account * Schedule C (from the tax returns) showing related business expense deductions * No history of delinquency on the account in question * Underwriting's business cash flow analysis including payment of the obligation | exclude the debt from the borrower's recurring monthly debt obligation. |

**Student Loans**

Include all student loans in the DTI regardless of deferment status or number of monthly payments remaining. When the credit report does not indicate a monthly payment, obtain documentation to support the payment amount.

**Taxes and Insurance**

Include the actual monthly amount of taxes**1**, insurance, any homeowners association (HOA) fees, and special assessment fees in the DTI.

**1** See [Tax Abatements](http://mbpp.jpmchase.net:8090/Credit_Policy/Debt_Analysis_Guidelines.htm#Tax_Abatements) below for more information.

**Tax Abatements**

Tax abatements are a temporary reduction in the actual amount of taxes that the owner(s) of a property must pay. Use the abated (reduced) amount of taxes in the qualifying DTI, when all of these requirements are met:

* A government municipality offers the abatement.
* Neither the seller, nor any other interested party, pays the abatement to the borrower.
* The full amount of the abatement is in effect for a minimum of three (3) years from the loan closing date and cannot terminate partially or fully within that period of time.
* Documentation supporting the amount and term of the abatement is in the loan file.

**Alert**: Never use tax abatements as a source qualifying income.

See [Appraisals](http://mbpp.jpmchase.net:8090/Collateral/Appraisals.htm) for tax abatement requirements related to Collateral policy.

**Travel and Entertainment (T & E) Credit Cards**

Exclude debt payments for travel and entertainment (T&E) credit cards if the borrower can provide verification that the borrower's employer reimburses 100% of these travel and entertainment expenses. Generally, two months of T&E card monthly billing statements showing prior balances paid in full meets this verification requirement.

Without this verification:

* Use the payment reflected on the credit report, or 5% of the outstanding balance reported on the credit report if the payment is absent.
* For open 30-day charge accounts with the total outstanding balance due monthly, the borrower(s) must have verified liquid assets exceeding the balance and meeting the reserve requirements for the loan program.

|  |  |
| --- | --- |
| **IF sufficient liquid assets are...** | **THEN...** |
| verified, | exclude the reported monthly payment from the DTI |
| not verified, | obtain evidence that the account has been paid in full, and exclude the reported monthly payment from the DTI. |

**Subordinate Financing**

**Policy**

Subordinate financing is any mortgage that is in a secondary or "junior lien" position on title. Recorded subordinate financing must meet specific repayment terms.

**Agency and Non-Agency Loan Eligibility Requirements**

Subordinate financing may not be eligible on all products, property, or occupancy types. Refer to the specific product guides to determine eligibility.

Additionally, there may be specific loan-to-value (LTV) and combined loan-to-value (CLTV) limitations associated with the seasoning of the subordinate financing.

The following restrictions apply:

* No negative amortization on the subordinate financing. The repayment terms of the subordinate loan must provide for regular payments that cover no less than interest due.
* The interest rate on the subordinate loan should generally be at market rate, but may be less if seller financed (no less than 2 percent below the market rate if not an equity line of credit).
* The maturity date of the subordinate loan must be five years or greater if the terms contain a balloon or call option.
* Variable payments are acceptable unless the first mortgage has an interest rate buydown, in which case, the subordinate financing must be a fixed amount. Unless the variable rate subordinate loan is an equity line of credit, the monthly payment must remain the same for each 12-month period and the interest rate may adjust no more than 1% each 12 months. If the subordinate loan does not fully amortize, it cannot mature or balloon in less than five years.
* The payment for the subordinate financing must be included in the total monthly housing expense and the P/I and D/I ratios.
* If the subordinate loan is an equity line of credit, use the line limit to calculate the LTV/CLTV.
* To be eligible, subordinate financing cannot have payment terms that restrict prepayment (i.e., prepayment penalties).

**Note**: Subordinate financing that allows lenders to recoup closing costs is not considered to be a prepayment penalty for the purpose of subordinate financing eligibility.

When the subordinate financing is not being paid off with proceeds of the refinance transaction, and remains subordinate to our first mortgage lien:

* The subordinate loan has no seasoning requirement (unless defined by the product guide).
* The subordinate financing must re-subordinate to our first mortgage and remain on the books.
* The subordinate financing must meet all product specific eligibility requirements.
* A copy of the Note reflecting the terms must be obtained in all cases regardless of lender (non-Streamline HARP).
  + Underwriting Institute subordinate financing complies with the above guidelines. However, all non-Underwriting Institute subordinate financing documentation must be reviewed to ensure our first lien priority and eligibility of the loan for sale in the secondary or securities market.

See [Subordinate Financing Guidelines – Agency Loans](http://mbpp.jpmchase.net:8090/Retail_Policies_and_Procedures/Subordinate_Financing_Guidelines_-_Agency_Guidelines.htm) for complete details.

**Re-subordination**

Requests for Lending Book to re-subordinate a loan in its servicing portfolio should be referred to the Servicing Department.

**Small Business Administration (SBA) Liens**

Small Business Administration (SBA) liens must be included in the CLTV calculation for both Agency and Non-Agency loans.

SBA's lien against an individual's personal residence is typically additional collateral for a business loan and not the primary collateral nor the primary source of repayment. However, the business must be analyzed to determine its ability to service the business debt as well as provide sufficient income for the borrower to service their debt.

The SBA lien should be entered as subordinate financing in any of the Automated Underwriting (AU) systems. The loan should reflect the subordination of the SBA lien to all Underwriting Institute liens.

In addition, monthly payments on the SBA Loan must be included in the DTI ratio unless proof is provided that the business is paying the debt in both of the following manners:

* A minimum of the most recent 12 months canceled checks from business' checking account.
* Business tax returns reflecting the related business expense deductions.

**Note**: the following conditions must be met:

* The account in question does not have a history of delinquency.
* Underwriting's analysis of the business took the payment of the obligation into consideration