TOWNE MORTGAGE COMPANY

BULLETIN

TO: Our Valued Clients

DATE: February 18, 2016

SUBJECT: Fannie Self Employed Income Documentation

BULLETIN: 16-04

***** IMPORTANT NOTICE *****

Fannie Mae has made significant changes to self-employment income policy regarding how to calculate and document self-employment income for borrowers whose income is derived from either a Partnership or a Subchapter S Corporation. Up until now, lenders had regularly used the ordinary business income (or loss) as reported on the K-1 1065 for Partnerships and K-1 1120s for S Corporations and flowed through to the Borrower's personal tax returns along with regular W/2 income from the business.

Fannie Mae does not consider this method reliable since the taxable income on a K-1 does not represent money that the borrower actually received, only what the partner/shareholder may be liable for tax on his/her share of the business income. Therefore, Fannie Mae updated their income calculation guidelines to state that generally ONLY distributions actually received by the borrower can be used in the income calculations. Exceptions can be made if the most recent balance sheet demonstrates the business has adequate liquidity to support that the borrower would have had the ability to withdraw funds in an amount **equal** to the ordinary business income.

Though not as detailed, Freddie Mac guidelines are clearly in line with Fannie Mae's. Therefore, effective with loan applications dated **on or after February 19th, 2016** underwriters will calculate self-employed income based on the attachment to this bulletin "How to calculate income reported on K-1 for Partnership or S Corp"

Fannie Mae Guidance for documenting access to income and business liquidity

- If the Schedule K-1 reflects a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then no further documentation of access to income or adequate business liquidity to support the withdrawal of earnings is required in order to include that income in the borrower's cash flow.
- If the Schedule K-1 does not reflect a documented, stable history of receiving cash distributions of income from the business consistent with the level of business income being used to qualify, then the lender must confirm the following to include the income in the borrower's cash flow:
  - the borrower can document access to the income (for example, via a partnership agreement or corporate resolution), and
  - the business has adequate liquidity to support the withdrawal of earnings.

Note: The lender is not required to confirm access to the income when the borrower(s) own 100% of the business.

Please contact your Account Executive with any questions.

Thank you,
Operations Group
Towne Mortgage Company