

Fannie Mae Single Family / 2013 Selling Guide / Part B, Origination Through Closing / Subpart B3, Underwriting Borrowers / Chapter B3-3, Income Assessment / Section B3-3.2, Self-Employment Income / B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower (04/09/2013)



B3-3.2-01, Underwriting Factors and Documentation for a Self-Employed Borrower (04/09/2013)

Introduction

This topic contains general information on underwriting factors and documentation for a self-employed borrower, including:

- Factors to Consider for a Self-Employed Borrower
- Length of Self-Employment
- Verification of Income
- Analysis of Borrower's Personal Income
- Analysis of Borrower's Business Income
- Income Verification for Self-Employed Co-Borrowers
- Verbal Verification of Employment

Factors to Consider for a Self-Employed Borrower

Any individual who has a 25% or greater ownership interest in a business is considered to be self-employed.

The following factors must be analyzed before approving a mortgage for a self-employed borrower:

- the stability of the borrower's income,
- the location and nature of the borrower's business,
- the demand for the product or service offered by the business,
- the financial strength of the business,
- the ability of the business to continue generating sufficient income to enable the borrower to make the payments on the requested mortgage, and
- the marketability of the property that is security for the mortgage as a private residence (rather than as the location of a business), since the property could be the source of repayment for the mortgage should the borrower's business fail.

Length of Self-Employment

Fannie Mae generally requires lenders to obtain a two-year history of the borrower's prior earnings as a means of demonstrating the likelihood that the income will continue to be received.

However, a person who has a shorter history of self-employment — 12 to 24 months — may be considered, as long as the borrower's most recent signed federal income tax returns reflect the receipt of such income as the same (or greater) level in a field that provides the same products or services as the current business or in an occupation in which he or she had similar responsibilities to those undertaken in connection with the current business. In such cases, the lender must give careful consideration to the nature of the borrower's level of experience, and the amount of debt the business has.



Verification of Income

The lender may verify a self-employed borrower's employment and income by obtaining from the borrower copies of his or her signed federal income tax returns (both individual returns and business returns) that were filed with the IRS for the past two years (with all applicable schedules attached).

Alternatively, the lender may use IRS-issued transcripts of the borrower's individual and business federal income tax returns that were filed with the IRS for the most recent two years—as long as the information provided is complete and legible and the transcripts include the information from all of the applicable schedules. (See B3-3.1-06, Requirements and Uses of IRS Form 4506-T (05/15/2012).)

The lender may waive the requirement for business tax returns if:

- The borrower is paying the down payment and closing costs with his or her own funds,
- The borrower has been self-employed in the same business for at least five years, and
- The borrower's individual tax returns show an increase in self-employment income over the past two years.

Analysis of Borrower's Personal Income

The lender must prepare a written evaluation of its analysis of a self-employed borrower's personal income, including the business income or loss, reported on the borrower's personal income tax returns. The purpose of this written analysis is to determine the amount of stable and continuous income that will be available to the borrower.

The lender may use Fannie Mae's *Cash Flow Analysis* (Form 1084) or any other type of cash flow analysis that applies the same principles as Fannie Mae's form.

A copy of the written analysis must be included as part of any loan application package that the lender submits to Fannie Mae for a mortgage that is selected for a post-purchase quality control review.

Analysis of Borrower's Business Income

The lender must prepare a written evaluation of its analysis of the borrower's business income. The lender must evaluate the borrower's business through its knowledge of other businesses in the same industry to estimate the potential for long-term earnings.

The purpose of this analysis is to:

- measure year-to-year trends for gross income, expenses, and taxable income for the business,
- determine (on a yearly or interim basis) the percentage of gross income attributed to expenses and taxable income, and
- determine a trend for the business based on the change in these percentages over time.

The lender may use Fannie Mae's *Comparative Income Analysis* (Form 1088) or any other method of trend analysis that enables it to determine a business's viability, as long as the method used presents fairly the viability of the business and results in a degree of accuracy and a conclusion that is comparable to that which would be reached by use of Form 1088.

A copy of the written analysis and conclusions must be retained in the individual mortgage file.

Income Verification for Self-Employed Co-Borrowers

When a salaried (or commissioned) borrower and a self-employed co-borrower jointly apply for a mortgage and the self-employed co-borrower's income will not be used for qualifying

purposes, the self-employed co-borrower's last two years of complete individual and business tax returns or other financial information related to the business are not required. Instead, the self-employed co-borrower may provide a copy of the first page of his or her latest individual federal income tax return, which will enable the lender to determine whether there was a meaningful business loss. When that is the case, the lender may decide that it needs to request additional information about the self-employed co-borrower's business income in order to reach a final underwriting decision.

Verbal Verification of Employment

For requirements regarding verbal VOEs, see B3-3.1-07, Verbal Verification of Employment (05/15/2012).

Related Announcements

The table below provides references to the Announcements that have been issued that are related to this topic.

Announcements	Issue Date
Announcement SEL-2013-03	April 9, 2013
Announcement SEL-2010-13	September 20, 2010
Announcement SEL-2010-02	March 2, 2010
Announcement 09-19	June 8, 2009