

What's Trending in MPF® Quality Control

February 8, 2024



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MPF Quality Control

How many file reviews did MPF QC complete in 2023?

- a. 1,968
- b. 2,946
- c. 3,139
- d. 4,377

c. 3,139

Roughly 25% of the files reviewed had zero exceptions.

A total of 3,205 exceptions were cited.

Documentation issues were prevalent in files with multiple exceptions.

- Missing documentation
- Documentation not adequate to support a decision.
- Documentation not matching DU or LPA findings.

QC Timeline Overview



*Every request for follow-up documentation after the initial 15-day response is received allows for an additional 7 days to provide the missing information. 30 days are provided for title or transcript exceptions.

Non-responsiveness will result in self-reporting to the investor. You will be notified when the last attempt is made prior to the self-report. It is imperative that any issues causing a delay in uploading are communicated.

All examples are reflected in calendar days.

Transcripts

Tax Transcripts

When a loan file is requested for a QC review, tax return transcripts must be included in the file

- You are not required to use transcripts to underwrite the loan.
- If transcripts are not obtained for underwriting, a **4506-C** must be completed and signed at closing so that transcripts may be obtained if the loan is chosen for a QC review.
- Borrower income validated through DU validation services (Day 1 Certainty®) or Freddie Mac's LPA validation service do not require transcripts*.

*Any income not validated through one of the validation services requires transcripts.



Tax Transcripts

Other important things to know about tax transcripts

- If tax returns were not required to underwrite a file, only request transcripts for the documentation that was used (i.e., W2's).
- When business returns are used to calculate income, transcripts of the business returns must be provided.

U.S. Income Tax Return for an S Corporation

Form 1120S

Department of the Treasury
Internal Revenue Service

For calendar year 2015 or tax year beginning

A S election effective date

B Business activity code (see instructions)

NAME

Number, street, and room or suite no. If a P.O. box, see instructions.

City or town, state or province, country, and ZIP or foreign postal code

Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. Instructions are at www.irs.gov/fo

2015, ending

TYPE OR PRINT

Yes No If

Amended return

Income Calculations and Employment

Employed or Not Employed?

There have been instances of a borrower not being employed at the time of closing

- Employment should be confirmed no more than 10 business days prior to the note date.
- Verifications may also be completed after closing (must occur prior to loan delivery).
- If self-employed, confirm that the business is still operating.
 - ✓ Company website
 - ✓ Contact by telephone or other means



Employed or Not Employed?

A suggested best practice is to have the borrower complete an “employment attestation” at or before closing

TRANSACTION DETAILS

I have applied for the above referenced mortgage loan. I certify that I am still employed at
ABC COMPANY

In addition, I do not believe there will be a change in my employment status in at least the next 30 days.

I have made no misrepresentations in the loan application or other documents, nor did I omit any pertinent information.

Borrower

Date

Still in Business?

The existence of a self-employed borrower's business must be verified

Lenders must verify the existence of a borrower's business within 120 calendar days prior to the note date.

- Third party such as a CPA
- Regulatory agency
- Licensing bureau
- Verify a phone listing and address via a phone directory, internet or directory assistance.

Don't forget to document the source of the information and include the name and title of the employee at your organization who obtained the information.

Tax Returns

Which of the following situations would require tax returns?

- a. Income is received from seasonal unemployment.
- b. Tip income reported on IRS Form 4137 is not on the borrower's W2s.
- c. The borrower is employed by an interested party to the transaction.
- d. The borrower is a contract employee.

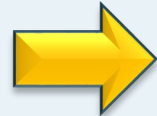
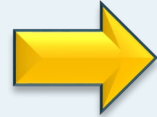
All the above require tax returns.



Verifications of Employment

When using DU/LPA or manually underwriting an MPF Xtra loan, which of the following are alternative methods to obtaining a verbal verification of employment (VVOE) for hourly, salary and commission income?

- a. An email from the borrower's employer within 10 business days of the note date.
- b. Within 15 business days of the note date, the borrower can provide their most recent paystub as of that date.
- c. Bank statements dated no earlier than 15 days prior to the note date.
- d. All the above.



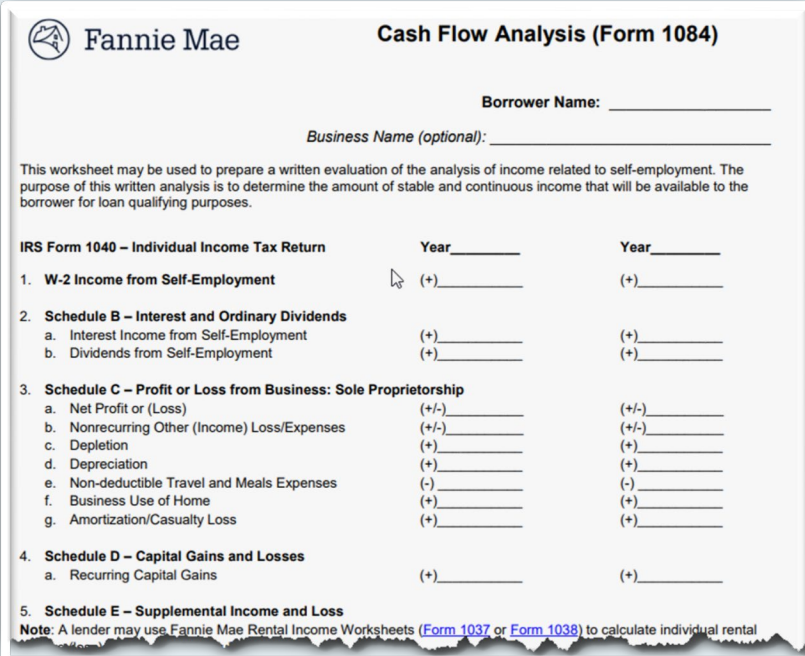
- Confirm that the email address for the employer is accurate.
- Make sure the email contains the borrower's name, employer's name, title, the contact's email address, date of contact, and the borrower's current employment status.
- Must show information for the most recent expected pay period based on the date of the paystub and the borrower's pay cadence.
- Must show information for the most recent expected pay period based on the date of the statement and the borrower's pay/deposit cadence.

d. All the above.

Self-Employed Income

Income worksheets should be used to show how income was calculated

- Many files arrive in QC without any evidence of how income was determined.
- We suggest using either Fannie Mae Form **1084** or Freddie Mac Form **91** (or something equivalent) to analyze tax returns.
 - There are also worksheets available to analyze rental income.
 - Many of the MI companies have excellent worksheets as well.



The image shows a Fannie Mae Cash Flow Analysis (Form 1084) worksheet. It is a form used to evaluate self-employment income for loan qualification. The form includes fields for the borrower's name, business name, and the year of the tax return. It is divided into sections for different types of income and expenses, with lines for positive and negative amounts. The sections include:

- IRS Form 1040 – Individual Income Tax Return**
- 1. W-2 Income from Self-Employment**
- 2. Schedule B – Interest and Ordinary Dividends**
 - a. Interest Income from Self-Employment
 - b. Dividends from Self-Employment
- 3. Schedule C – Profit or Loss from Business: Sole Proprietorship**
 - a. Net Profit or (Loss)
 - b. Nonrecurring Other (Income) Loss/Expenses
 - c. Depletion
 - d. Depreciation
 - e. Non-deductible Travel and Meals Expenses
 - f. Business Use of Home
 - g. Amortization/Casualty Loss
- 4. Schedule D – Capital Gains and Losses**
 - a. Recurring Capital Gains
- 5. Schedule E – Supplemental Income and Loss**

Note: A lender may use Fannie Mae Rental Income Worksheets (Form 1037 or Form 1038) to calculate individual rental income.

Using Income Worksheets

We recommend using worksheets even if the income is derived from only paystubs and W2s.

Many worksheets contain sections to help with bonuses and overtime.

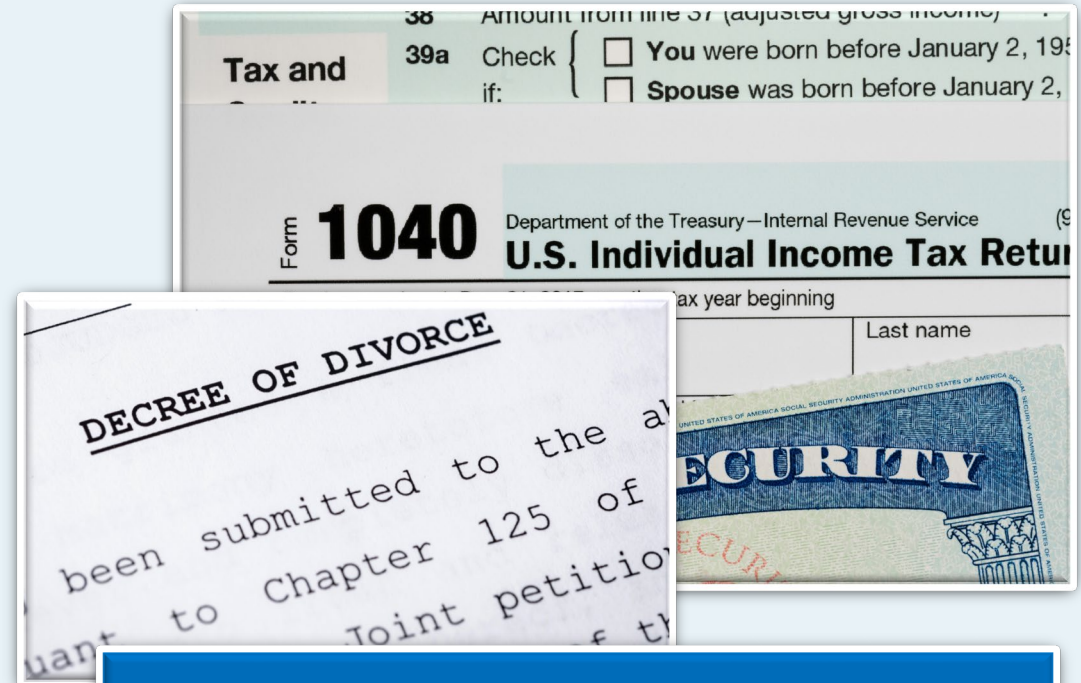
Income Calculation Worksheet									
Borrower Name				Loan Number				Date	
Employer						3/17/2022			
Pay Type									
Hourly									
		Per Hour	0	# of hours	X52/12	\$ -		Income	
	\$ -	YTD Earnings	0	# months				Income	
	\$ -	W2 for Tax Year:	0	# months				Income	
	\$ -	W2 for Tax Year:	0	# months				Income	
<input type="checkbox"/>	\$ -	Per Hour							
<input type="checkbox"/>		YTD Avg							
<input type="checkbox"/>		YTD + 1 Yr W2 Avg							
<input type="checkbox"/>		YTD + 2 Yr W2 Avg							
	\$ -	Use lowest income							
						or check the income you wish to use	\$ -		
Salary									
Type of Salary									
<input type="checkbox"/>		Monthly	X1	=		\$ -		Income	
<input type="checkbox"/>		Bi Weekly	X26/12	=		\$ -		Income	
<input type="checkbox"/>		Semi Monthly	X24/12	=		\$ -		Income	
<input type="checkbox"/>		Weekly	X52/12	=		\$ -		Income	
<input type="checkbox"/>		YTD Salary (paystub)	0	# months				Monthly Avg	
<input type="checkbox"/>		W2 income	0	# months				Income	
<input type="checkbox"/>		W2 Income	0	# months				Income	
	\$ -	Base Used to Qualify							
						check the salary you wish to use			
If YTD or past year is lower, confirm why. Otherwise, lower of YTD and W2 required.									
Overtime/Bonus									
Break out OT/Bonus from base salary									
	\$ -	YTD Overtime / Bonus*	0	# months				Income	
	\$ -	Past year OT breakout	0	# months				Income	
	\$ -	Additional year OT / Bonus	0	# months				Income	

Non-Taxable Income

When using DU or LPA underwrite, or manually underwriting the MPF Xtra product, which of the following is true when it comes to grossing-up non-taxable income sources?

- a. 15% of Social Security retirement income may be grossed-up by 25% without evidence the income is non-taxable.
- b. Child support income may be treated as non-taxable and may be grossed up by 25% without providing evidence the income is non-taxable.
- c. When grossing-up any portion of Social Security or child support income, tax returns must be obtained.

a. and b. are true.



Remember, if you want to gross-up more than 15% of SS retirement income, you may only gross up the portion that is not taxed. Tax returns must be provided to verify the amount not subject to tax.

Non-Retirement Social Security

Social Security benefits can be paid to borrowers for reasons unrelated to retirement. Two of the most common income types are:

- **Disability benefits**
- **Survivor benefits (surviving spouse or children)**

Social Security Disability is generally paid to people who are unable to work for a year or more because of a disability. Certain family members of workers with disabilities can also receive benefits.

Survivor benefits may be paid to widows, widowers, and minor children of an eligible decedent.

What issues are we seeing with this type of income?

- **No evidence that the payments will continue for at least three years, especially for benefits paid to minor children.**
- **Grossing-up the full amount without evidence of the taxable vs. non-taxable portion.**

Short-Term and Long-Term Disability

Some disability income is not related to Social Security benefits and may come from a borrower's insurance coverage

- Do not confuse with Social Security disability benefits.
- Taxable vs. non-taxable grossing up rules apply.
- Usually, long-term disability does not have a defined expiration date and should be expected to continue.
- If required to be re-evaluated, that is not considered a defined expiration date.
- Borrowers receiving short-term disability that will decrease within the next three years because they are being converted to long term benefits must qualify using the amount of the long-term benefit.

Obtain a copy of the disability policy from the insurer or borrower's employer to determine:

- **The borrower's current eligibility for the benefit.**
- **What is the amount and frequency of the payments?**
- **Is there a modification or termination date in the policy?**

Income Trends

Carefully review income types that tend to vary, like self-employment, overtime, commissions, or bonuses.

- **Average** income that is documented to be stable or increasing.
- If income was **declining but has since stabilized** and evidence shows that the borrower will continue to receive income at the current level, **do not average, use the lower amount.**
 - ✓ If a self-employed borrower experienced a legitimate one-time expense (due to a natural disaster, equipment purchase, etc.) don't forget to note the expense in the file.
- Declining income with no indication of stabilization should not be used.



Variable Income

Many borrowers who are not self-employed may receive income that is considered variable. The most common types of variable income include:

- Overtime
- Bonuses/Tip Income
- Commissions
- Hourly workers with fluctuating hours

DU and LPA findings will not provide the correct messaging if variable income is not itemized.

Variable income from overtime, bonuses/tips, and commissions must be separated from base earnings.

Gross Monthly Income		
Base	\$ 3,467	/month
Overtime	\$	/month
Bonus	\$	/month
Commission	\$ 972	/month
Military Entitlements	\$	/month
Other	\$	/month
TOTAL \$	4,321	/month

Variable Income

Let's meet Maria. She works 40 hours a week in retail sales. In addition to her base hourly pay, she receives a commission on her sales.



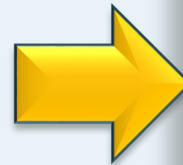
Common calculation mistakes:

- Using only the YTD total income from the pay stub(s) and ignoring the amount earned in the previous year(s).
- Not considering how the income is trending.
- Using income that has been declining and there's no evidence it has since stabilized.
- Averaging declining income that has since stabilized/increased.
- Not obtaining a breakout of the borrower's base vs. variable income history.

Variable Income

Documentation needed to analyze variable income not related to self-employment

- Recent paystubs to evidence YTD
- A breakdown of base vs. the variable income source
 - VOE
 - Vendor-supplied income validation
- W2s



12B. Gross Earnings			
Type	Year To Date Thru 2-2-2024	Past Year 2023	Past Year 2022
Base Pay	\$ 4,000	\$ 40,560	\$ 39,520
Overtime	\$	\$	\$
Commissions	\$ 1,171	\$ 14,344	\$ 13,840
Bonus	\$	\$	\$
Total	\$ 5,171	\$ 54,904	\$ 53,360

Since it's early in the year, consider a 25-month average of commissions.

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Military Entitlements	\$ /month
Other	\$ /month
TOTAL \$	4,321 /month

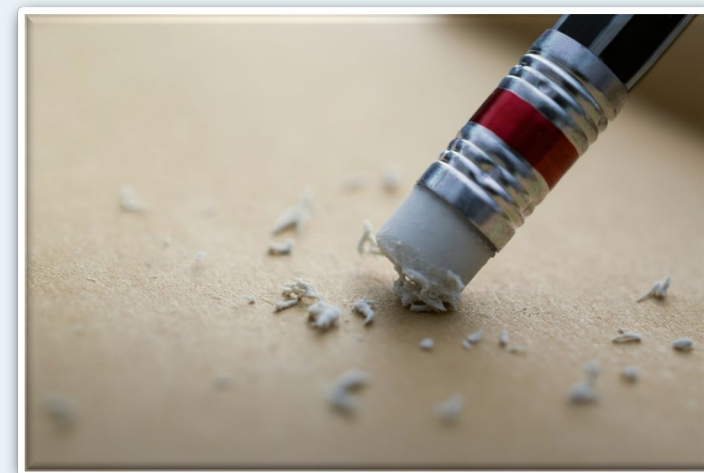
Additional Income Oversights

- Missing documentation for self-employed borrowers with multiple businesses. All businesses must be documented and part of the analysis, even if not needed for qualifying purposes.
- If a self-employed borrower has a business (or businesses) listed on Schedule E, K1s and complete personal tax returns must be provided regardless of percentage owned. If they own 25% or more of that business, complete business tax returns are also required.
- Information entered incorrectly into DU or LPA, may result in faulty findings.



Additional Oversights (continued)

- Schedule C income increased over the past two years, but only the previous year's income was used when both years should have been averaged.
- A 24-month average was used when income declined.
- Failure to use a worksheet resulted in ineligible items being added back as income.
- Capital gains income being used when it wasn't recurring.



Liabilities

Mortgage Charge-Offs

A charge-off of a mortgage occurs when a lender determines that there is little or no likelihood that a mortgage debt will be collected.

They are typically reported after a loan reaches a certain delinquency status.

Even if paid off, do not confuse mortgage charge-offs with charge-offs related to other liability types. Mortgages do not follow the same guidelines.

What is the typical waiting period if borrower experienced a mortgage charge-off ?

- a. 2 years**
- b. 3 years**
- c. 4 years**

c. 4 years, but if extenuating circumstances can be documented, 2 years may be acceptable.

Credit Reports

What's the maximum age of a credit report?

- a. 60 days
- b. 90 days
- c. 120 days
- d. 180 days

c. 120 days

As of what date? **The note date.**

How confident are you that a borrower's credit history didn't change between the credit report date and closing?



Undisclosed Liabilities

- New debt established prior to closing that was not reflected on the initial credit report and therefore not included in the debt to income (DTI) ratio.
- Purchases of large ticket items such as furniture and automobiles are common.
- Watch for large increases in disclosed debt, this can be just as concerning as a new liability.



Undisclosed Liabilities

What if undisclosed liabilities are discovered just prior to closing?

- The file should be re-underwritten using the higher DTI ratio.
- If underwritten using DU or LPA, the applicable tolerances for resubmission must be followed.



Miscellaneous

Appraisals

Appraisals marked “**as is**” may be acceptable if the conditions are minor, and do not impact the safety, soundness or structural integrity of the property

Which of the following may be considered “minor” or “deferred maintenance”?



Reminder: All appraisals must include color photos!

Appraisals

Things to consider when reviewing an “as is” appraisal

Minor conditions and deferred maintenance are typically due to normal wear and tear and generally do not rise to the level of required repair but do need to be reported.

Examples of deferred maintenance may include:

- Worn flooring or carpeting
 - Minor plumbing leaks
 - Holes in window screens
 - Cracked windows
- **Appraisers are not inspectors.** An inspection by a professional may be necessary to support the acceptance of an appraisal marked “**as is**”.
 - It is your responsibility to determine if an inspection is required and whether the property meets eligibility requirements.



Appraisals

The *Appraisal Update and/or Completion Report* (Form 1004D)

Form 1004D (or an acceptable alternative) is required whenever an appraisal is made “subject to” completion or repairs.

- Purchase of new construction home (if not 100% complete at the time the initial appraisal was completed).
- Construction to permanent loans
- Appraisals made “subject to” repairs

What have we noticed?

1004Ds are missing from loan files and not being requested when required.

Form 1004D

There are alternative completion methods for Form 1004D that may be acceptable in certain circumstances.

Which of the following are acceptable for a “subject to” appraisal that conditions for the completion of new construction per plans and specifications?

- a. Form 1004D with the appraiser performing a site visit.
- b. Form 1004D with the appraiser providing evidence of a virtual inspection.
- c. An attestation letter from the builder/borrower that includes supporting evidence of completion.

All are acceptable.

Completion alternatives vary depending upon the valuation method and condition (i.e., completion or repair)

Review the guidelines for more details about virtual inspections and attestation letters



Construction-to-Permanent Loans

How to determine if a dual-close (or two-close) construction loan is a limited cash-out (LCOR) or a cash-out refinance

Limited Cash-Out Refinance

- Pay off the construction loan.
- Payoff of any secondary liens used to fund overruns. 100% of proceeds must have been used for construction costs only. Evidence is required.
- Closing costs and pre-pays.
- Cash-back not to exceed the lesser of \$2,000 or 2% of the principal balance of the new loan.
- **Out-of-pocket construction overruns paid by the borrower from credit cards, unsecured loans, or their own funds cannot be reimbursed with the loan proceeds.**

Cash-Out Refinance

- Pay off the construction loan.
- Pay off any secondary liens related or unrelated to construction.
- Closing costs and pre-pays.
- Reimburse the borrower for out-of-pocket expenses.
- Other cash-out as equity allows.

Fannie Mae C-P FAQs: <https://singlefamily.fanniemae.com/learning-center/originating-and-underwriting/faqs-construction-permanent-financing>

Right to Cancel

The Right to Cancel (or Right of Recission) rules can be confusing when the transaction is a construction-to-permanent loan

Which transactions related to new construction require Right of Recission documents at closing?

- Closing of a limited cash-out refinance to pay off a construction loan (dual-close). **NO**
- Closing of a cash-out refinance to pay off a construction loan (dual-close). **YES**
- Closing of a single-close construction-to-permanent loan. **NO**



Reminder

- It's important to make sure that your contacts within eMAQCSplus are up to date.
- Please review your contacts and users and let us know if any changes need to be made!



MPF Contacts and Resources

MPF Service Center

- Email - MPF-Help@FHLBC.com
- Hours - 8:30 am to 4:30 pm CST
- Phone: (877) 345-2673

eMAQCSplus Resource Page

<https://www.fhlbmpf.com/resources/emaqcs-plus>

MPF Quality Control

mpfinvestordirectqc.fhlbc.com



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FEBRUARY 26 2024	1:00 PM - 2:00 PM CT MPF® University Welcomes Radian: Reviewing Rural Property Appraisals	REGISTER >>>
FEBRUARY 27 2024	1:00 PM - 2:00 PM CT Researching Turnaround Reports and Submitting Exception Clearing Reports	REGISTER >>>
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