

WHOLESALE BULLETIN

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19W-014

Attention: Business Development Managers & Mortgage Brokers

February 28, 2019

Please take a moment to read the important information contained in this bulletin.

Included in this Bulletin: Freddie Mac Rental Income Effective March 1, 2019

Freddie Mac has announced the following new rental income guidance, effective March 1, 2019:

General Eligibility Requirements

Stable monthly rental income must be generated from acceptable and verifiable sources and must be reasonably expected to continue for at least the next three years. For each income source used to qualify the Borrower, the Underwriter must determine that both the source and the amount of the income are stable. Rental income generated from the following property and occupancy types may be considered when determining the stable monthly income:

- 1-unit Primary Residence (rental income from a live-in aide is eligible)
- Subject 2- to 4-unit Primary Residence (rental income is eligible from units that are not occupied by the Borrower)
- Subject 1- to 4-unit Investment Property
- Non-subject investment property owned by the Borrower (not restricted to residential property (e.g., commercial permitted))

Accessory Units

When determining stable monthly income, rental income generated from an accessory unit may be considered for:

- Subject 1-unit Investment Property
- Non-subject Investment Property

Second Homes

Rental income generated from the Borrower's second home may not be used as stable monthly income.

Rental Income from the Borrower's 1-unit Primary Residence

The following chart contains requirements related to rental income from a Borrower's 1-unit Primary Residence:

1-unit Primary Residence rental income eligibility requirements	
Eligibility	Rental income generated from the Borrower's 1-unit Primary Residence, including rental income from an accessory unit, may be used to qualify a Borrower with a disability provided the rental income is from a live-in aide. Typically, a live-in aide will receive room and board payments through Medicaid waiver funds from which rental payments are made to the Borrower.
Documentation	Evidence that the Borrower has received stable rental income from a live-in aide for the most recent 12 months.
Qualification	The rental income may be considered in an amount up to 30% of the total stable monthly income that is used to qualify the Borrower for the mortgage.

Rental income from the Borrower's subject 2- to 4-unit Primary Residence, subject 1- to 4-unit Investment Property and non-subject investment property

This section contains requirements and guidance for the history, documentation, analysis, calculation and determination of stable monthly net rental income.

Appraisal Form Documentation and Analysis

The following chart contains requirements related to appraisal form documentation and analysis:

Appraisal forms – comparable rent data		
Subject	Subject 1-unit Investment Properties	Subject 2- to 4-unit Primary Residences Subject 2- to 4-unit Investment Properties
Documentation	Form 1000, Single Family Comparable Rent Schedule	Form 72, Small Residential Income Property Appraisal Report
Analysis	<p>The Underwriter's analysis of the rental information must include, at a minimum, the following factors:</p> <ul style="list-style-type: none"> Rental market viability and income producing potential for subject property Whether the current market rents reasonably support the gross rents reported on Schedule E or the gross monthly lease income, if applicable. If the current market rents do not reasonably support the gross rents reported on Schedule E or the gross monthly lease income, the Underwriter must: <ul style="list-style-type: none"> Determine if additional documentation is necessary to support income stability, and Provide a written analysis explaining the discrepancy and 	

justifying the determination that the rental income used to qualify the Borrower is stable and reasonably expected to continue

Documentation, History and Analysis

The following charts contain requirements and guidance for documentation, history and analysis.

Subject	Subject property purchase transaction	Subject property refinance transaction or non-subject investment property <ul style="list-style-type: none"> • Property purchased in the current calendar year, or Property placed in service for use as a rental property in the current calendar year
Documentation and analysis Streamlined Accept and Standard Documentation Levels	<ul style="list-style-type: none"> • A lease, if available, must be used to determine the net rental income. The Underwriter must make reasonable efforts to determine lease availability, including review of the appraisal, comparable rent data, purchase contract, a discussion with the Borrower and/or any other applicable and reasonable method. <p style="text-align: center;">or</p> <ul style="list-style-type: none"> • If a lease is not available, Forms 72 or 1000, as applicable, may be used to determine the net rental income 	<ul style="list-style-type: none"> • Lease must be used to determine the net rental income • Purchase date or conversion date, as applicable, must be documented
Lease requirements	Leases must be current and fully executed, with a minimum original term of one year. If the lease is documented as assigned from the property seller to the Borrower and is in the automatically renewable month-to-month phase of an original one-year (or longer) term lease, then a month-to-month term is acceptable.	
Maximum eligible amount of net rental income	<ul style="list-style-type: none"> • The Borrower must currently own a Primary Residence to use rental income to qualify when purchasing a new rental property in the current calendar year. In such instances, rental income can only offset the principal, interest, taxes and insurance (PITI) of the new rental property. • If the Borrower's current Primary Residence is being converted to a rental property, rental income can only offset the PITI of that Primary Residence. • If the rental income exceeds the PITI of the new rental property or the converted Primary Residence, as applicable, the excess rental 	

	income cannot be added to the Borrower's gross monthly income to qualify unless the file documentation demonstrates the Borrower has a minimum of one-year investment property management experience.
Documentation Streamlined Accept and Standard Documentation Levels	<p>If the Borrower qualifies with the full monthly payment amount for the subject Investment Property and/or non-subject investment property are included in the Borrower's monthly debt payment-to-income ratio, no further evaluation or calculation of rental income from the subject Investment Property and/or non-subject investment property is required.</p> <p>If rental income from the subject Investment Property and/or non-subject investment property is to be considered in qualifying the Borrower, the following requirements apply:</p> <ul style="list-style-type: none"> • The Underwriter must obtain the Borrower's federal income tax returns (Internal Revenue Service (IRS) Form 1040) including the Schedule E for the most recent year. If the income from the subject property is reported on the Borrower's federal income tax returns, the Underwriter must use the Schedule E to determine the net rental income. • If the subject property has been owned for at least one year and is reported on the Schedule E of the Borrower's prior year federal income tax return, use the income or loss as reported • A signed lease may be used if the property was out of service for any time period in the prior year and the Schedule E supports this by a reduced number of days in use and reflects repair costs. Form 72 or 1000 must support the income reflected on the lease. • If the number of days the property was in service is reduced on the Schedule E and the file does not contain a documented event such as a renovation or repair or evidence the property was purchased later in the calendar year, the rental income or loss from the Schedule E must be used and annualized for qualifying purposes

Net rental income calculation requirements

The following chart contains requirements pertaining to net rental income calculation.

Rental income source	Calculation requirements
Lease <u>Forms 72</u> or <u>1000</u>	<ul style="list-style-type: none"> • 75% of the gross monthly rent or gross monthly market rent. • The 25% adjustment is made to compensate for vacancies, operating and maintenance costs, and any other unexpected expenses.
Schedule E	<p>The net rental income for each individual property is determined based on the history of income and expenses reported on Schedule E. Calculate the net rental income from Schedule E using <u>Form 92, Net Rental Income Calculations – Schedule E</u>, or a similar alternative form, as follows:</p> <p>Rents received - Less total expenses <i>Add back the following expenses:</i> + Insurance + Mortgage interest paid to banks, etc. + Taxes (real estate taxes only)</p>

	<ul style="list-style-type: none"> + Depreciation and/or depletion + Homeowners association dues (if specifically reported as an expense) + One time losses (e.g., casualty loss due to documented catastrophic event); <p>Result: Net rental income (calculated to a monthly amount)</p> <p>When calculating the net rental income for each individual property, the following expenses reported on Schedule E (and noted above) can only be added back if they are included in the payment amount being used to establish the debt payment-to-income ratio for that property: insurance, mortgage interest paid to banks, real estate taxes, and homeowners association dues.</p>
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Establishing the debt payment-to-income ratio

The following chart contains requirements pertaining to establishing the debt payment-to-income ("DTI") ratio.

Subject	Requirements
Net rental income amount and usage	When establishing the DTI ratio, refer to Net Rental Income calculation requirements.
Subject 2- to 4-unit Primary Residence	<ul style="list-style-type: none"> • The monthly housing expense must be added as a liability • The net rental income may be added to the stable monthly income
Subject 1- to 4-unit Investment Property	Subtract the monthly payment amount from the net rental income: <ul style="list-style-type: none"> • If the result is positive, add it to the stable monthly income • If the result is negative, add it to the monthly liabilities
Rental income from non-subject investment property owned by the Borrower	Subtract the monthly payment amount from the net rental income: <ul style="list-style-type: none"> • If the result is positive, add it to the stable monthly income • If the result is negative, add it to the monthly liabilities <p>For multiple non-subject investment properties, apply the calculation above to each property, and:</p> <ul style="list-style-type: none"> • If the combined result is positive, add it to the stable monthly income • If the combined result is negative, add it to the monthly liabilities

IRS Form 8825, Rental Real Estate Income and Expenses of a Partnership or an S Corporation

For the treatment of all rental real estate income or loss reported on the IRS Form 8825, which reflects all income and expenses for the rental property and the IRS Schedule K-1, which reflects the Borrower's proportionate share of the net rental income or loss. The requirements are applicable regardless of the Borrower's percentage of ownership interest in the partnership or S corporation and regardless of whether the Borrower is personally obligated on the Note.

Author: Underwriting