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Self Employed

Fannie Mae & Freddie Mac

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TABLE OF CONTENTS

Module 1: Introduction to Self-Employed Borrowers and Mortgages 3
Overview of Fannie Mae and Freddie Mac Mortgages 3
Fannie Mae and Freddie Mac's Role in the Mortgage Market 3
Conforming Loans 4
Benefits of Fannie Mae and Freddie Mac Mortgages for Self-Employed Borrowers 4
Importance of Understanding Self-Employed Borrower Guidelines 4
1. Mortgage Approval Chances 5
2. Accurate Representation of Income 5
3. Efficient Mortgage Application Process 5
4. Avoiding Potential Pitfalls 5
5. Staying Up-to-Date with Changing Guidelines 5
Module 2: Consistency and Continuance of Income 6
Income Stability and Its Impact on Mortgage Approval 6
Introduction 6
What is Income Stability? 6
Why is Income Stability Important for Mortgage Approval? 6
Factors Affecting Income Stability for Self-Employed Borrowers 6
How to Demonstrate Income Stability as a Self-Employed Borrower 7
Conclusion 7
Module 2: Consistency and Continuance of Income 8
Continuance of Income and Its Role in Mortgage Underwriting 8
Module 3: Income Trends and Cash Flow Analysis 10
Analyzing Income Trends for Self-Employed Borrowers 10
Introduction 10
Importance of Analyzing Income Trends 10
Key Factors to Consider 10
Analyzing Income Trends: An Example 11
Conclusion 11
Module 3: Income Trends and Cash Flow Analysis 11
Cash Flow Analysis Using Bank Statements and Gross Sales Receipts 11

Module 4: Mortgage Underwriting Guidelines for Self-Employed Borrowers 13
B3-3.2-01: Underwriting Factors and Documentation for a Self-Employed Borrower 13
Introduction 13
Underwriting Factors for Self-Employed Borrowers 13
Documentation Requirements for Self-Employed Borrowers 14
Conclusion 14
Module 4: Mortgage Underwriting Guidelines for Self-Employed Borrowers 15
Key Factors to Consider for Self-Employed Borrowers 15
Module 5: Analyzing Business Structures and Their Impact on Mortgages 17
Sole Proprietorships 17
Partnerships 17
Limited Liability Companies (LLCs) 17
S Corporations 18
Corporations 18
Module 5: Analyzing Business Structures and Their Impact on Mortgages 19
How Different Business Structures Affect Mortgage Approval 19
Module 6: Verification of Income and Analysis of Borrower's Personal and Business Income 21
Methods for Verifying Self-Employed Income 21
1. Tax Returns 21
2. Profit and Loss Statements 21
3. Bank Statements 22
4. Business Licenses and Contracts 22
5. CPA or Tax Professional Letter 22
Module 6: Verification of Income and Analysis of Borrower's Personal and Business Income 23
Analyzing Personal and Business Income for Mortgage Approval 23
Module 7: Use of Business Assets and Income Verification for Self-Employed Co-Borrowers 25
Assessing the Impact of Using Business Assets for Down Payment, Closing Costs, and Reserves 25
Using Business Assets for Down Payment 25
Using Business Assets for Closing Costs 26
Using Business Assets for Reserves 26
Module 7: Use of Business Assets and Income Verification for Self-Employed Co-Borrowers 26
Income Verification Requirements for Self-Employed Co-Borrowers 26

Module 8: Conclusion and Additional Resources 28
Recap of Key Concepts and Guidelines 28
1. Overview of Fannie Mae and Freddie Mac mortgages 28
2. Consistency and Continuance of Income 29
3. Income Trends and Cash Flow Analysis 29
4. Mortgage Underwriting Guidelines for Self-Employed Borrowers 29
5. Analyzing Business Structures and Their Impact on Mortgages 29
6. Verification of Income and Analysis of Borrower's Personal and Business Income 29
7. Use of Business Assets and Income Verification for Self-Employed Co-Borrowers 29
Additional Resources 29

MODULE 1: INTRODUCTION TO SELF-EMPLOYED BORROWERS AND MORTGAGES

Welcome to the first module of our course on Self-Employed Borrowers and Fannie Mae and Freddie Mac Mortgages. In this module, we will introduce you to the world of self-employed borrowers and provide an overview of Fannie Mae and Freddie Mac mortgages.

OVERVIEW OF FANNIE MAE AND FREDDIE MAC MORTGAGES

Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation) are government-sponsored enterprises (GSEs) that play a crucial role in the U.S. mortgage market. They were established to provide liquidity, stability, and affordability to the mortgage market by purchasing and guaranteeing mortgages made by lenders.

FANNIE MAE AND FREDDIE MAC'S ROLE IN THE MORTGAGE MARKET

Fannie Mae and Freddie Mac do not directly provide mortgages to borrowers. Instead

, they buy mortgages from lenders, package them into mortgage-backed securities (MBS), and sell these securities to investors. By doing so, they provide a secondary market for mortgages, which helps lenders maintain a stable supply of mortgage credit and offer competitive interest rates to borrowers.

CONFORMING LOANS

Mortgages that meet the underwriting guidelines set by Fannie Mae and Freddie Mac are called conforming loans. These guidelines include loan limits, borrower credit scores, debt-to-income ratios, and documentation requirements. Conforming loans are generally considered less risky for lenders and investors, as they are backed by Fannie Mae and Freddie Mac.

BENEFITS OF FANNIE MAE AND FREDDIE MAC MORTGAGES FOR SELF-EMPLOYED BORROWERS

Fannie Mae and Freddie Mac have specific underwriting guidelines for self-employed borrowers, which can make it easier for them to qualify for a mortgage. These guidelines recognize the unique financial circumstances of self-employed individuals and provide flexibility in terms of income verification and documentation requirements.

Some benefits of Fannie Mae and Freddie Mac mortgages for self-employed borrowers include:

- Flexible income verification: Self-employed borrowers can use various documentation types, such as tax returns, profit and loss statements, and bank statements, to verify their income.
- Multiple sources of income: Fannie Mae and Freddie Mac guidelines allow self-employed borrowers to use income from multiple sources, such as rental properties or investments, to qualify for a mortgage.
- Loan-to-value (LTV) flexibility: Self-employed borrowers with strong credit profiles and financial reserves may qualify for higher LTV ratios, which can help them secure a mortgage with a lower down payment.

In the upcoming modules, we will dive deeper into the specific guidelines and requirements for self-employed borrowers seeking Fannie Mae and Freddie Mac mortgages. By understanding these guidelines, you can improve your chances of mortgage approval and better serve your self-employed clients.

In the next section, we will discuss the importance of understanding self-employed borrower guidelines. Stay tuned!

IMPORTANCE OF UNDERSTANDING SELF-EMPLOYED BORROWER GUIDELINES

As a self-employed individual or a mortgage professional working with self-employed clients, it is crucial to understand the guidelines that apply specifically to self-employed borrowers. These guidelines are essential for several reasons:

1. MORTGAGE APPROVAL CHANCES

Self-employed borrowers often face unique challenges when applying for a mortgage. They may have fluctuating income, complex tax returns, and multiple sources of income. By understanding the guidelines that apply to self-employed borrowers, you can better prepare your clients or yourself for the mortgage application process, ultimately improving the chances of mortgage approval.

2. ACCURATE REPRESENTATION OF INCOME

One of the primary concerns for mortgage lenders is ensuring that borrowers have sufficient and stable income to repay the loan. For self-employed borrowers, this can be more complicated than for salaried employees. Understanding the guidelines for calculating and verifying self-employed income will help you accurately represent the borrower's income, making it easier for the lender to assess their ability to repay the loan.

3. EFFICIENT MORTGAGE APPLICATION PROCESS

When you understand the guidelines for self-employed borrowers, you can streamline the mortgage application process. This will save both you and your clients time and effort, as you will be better prepared to gather the necessary documentation and information required by lenders.

4. AVOIDING POTENTIAL PITFALLS

By being familiar with self-employed borrower guidelines, you can help your clients avoid potential pitfalls in the mortgage application process. For example, you may be able to advise them on how to structure their business or report their income in a way that will be more favorable for mortgage approval.

5. STAYING UP-TO-DATE WITH CHANGING GUIDELINES

Mortgage guidelines can change over time, and it's essential to stay up-to-date with the latest requirements for self-employed borrowers. By keeping current

with these guidelines, you can ensure that you are providing the best possible advice and service to your clients.

In conclusion, understanding self-employed borrower guidelines is crucial for both mortgage professionals and self-employed individuals seeking mortgage approval. By familiarizing yourself with these guidelines, you can improve your clients' or your own chances of mortgage approval, streamline the application process, and stay current with the latest industry requirements.

MODULE 2: CONSISTENCY AND CONTINUANCE OF INCOME

INCOME STABILITY AND ITS IMPACT ON MORTGAGE APPROVAL

INTRODUCTION

Income stability is a crucial factor for mortgage lenders when assessing a borrower's ability to repay a loan. For self-employed borrowers, demonstrating consistent and stable income can be more challenging compared to salaried employees. In this section, we will discuss the importance of income stability for self-employed borrowers and its impact on mortgage approval.

WHAT IS INCOME STABILITY?

Income stability refers to the consistency and reliability of a borrower's income over time. Lenders prefer borrowers with stable income, as it indicates a lower risk of defaulting on the loan. For self-employed borrowers, income stability can be demonstrated through a consistent history of earnings and a sustainable business model.

WHY IS INCOME STABILITY IMPORTANT FOR MORTGAGE APPROVAL?

Mortgage lenders use income stability as a key indicator of a borrower's ability to make timely mortgage payments. A stable income reduces the likelihood of financial hardships that could lead to missed payments or default. For self-employed borrowers, income stability is especially important because their income may be more variable and less predictable than that of salaried employees.

FACTORS AFFECTING INCOME STABILITY FOR SELF-EMPLOYED BORROWERS

1. **Business longevity:** Lenders typically require self-employed borrowers to have a minimum of two years of continuous business operation to demonstrate income stability. A longer business history may be viewed more favorably by lenders.

2. **Income fluctuations:** Self-employed borrowers may experience fluctuations in income due to seasonal trends or economic cycles. Lenders will assess the borrower's ability to manage these fluctuations and maintain a stable income.

3. **Industry trends:** Lenders may consider the overall health of the borrower's industry when evaluating income stability. A declining industry may raise concerns about the borrower's future income potential.

4. **Debt-to-income ratio (DTI):** The DTI ratio is a measure of a borrower's monthly debt payments relative to their gross monthly income. A lower DTI ratio indicates a more stable income and a higher likelihood of mortgage approval.

HOW TO DEMONSTRATE INCOME STABILITY AS A SELF-EMPLOYED BORROWER

1. **Maintain accurate and organized financial records:** Lenders will require documentation to verify your income, such as tax returns, profit and loss statements, and balance sheets. Keeping accurate and organized records will make it easier to demonstrate income stability.

2. **Establish a track record of consistent earnings:** Lenders prefer borrowers with a history of consistent earnings. Aim to maintain or increase your income over time to demonstrate stability.

3. **Manage debt responsibly:** Maintain a low DTI ratio by managing your debt responsibly. Avoid taking on excessive debt and make timely payments on existing debts.

4. **Prepare for income fluctuations:** Establish an emergency fund to cover expenses during periods of reduced income. This demonstrates financial responsibility and reduces the risk of defaulting on your mortgage.

CONCLUSION

Income stability is a critical factor in mortgage approval for self-employed borrowers. Demonstrating a consistent and reliable income can improve your chances of securing a mortgage loan. By maintaining accurate financial records, establishing a track record of consistent earnings, managing debt responsibly, and preparing for income fluctuations, self-employed borrowers can increase their likelihood of mortgage approval.

MODULE 2: CONSISTENCY AND CONTINUANCE OF INCOME

CONTINUANCE OF INCOME AND ITS ROLE IN MORTGAGE UNDERWRITING

INTRODUCTION

When it comes to mortgage underwriting, one of the most critical factors that lenders consider is the borrower's ability to maintain a stable income. For self-employed borrowers, this can be particularly challenging, as income can often fluctuate due to the nature of their work. In this section, we'll discuss the importance of continuance of income for self-employed borrowers and its role in mortgage underwriting.

WHAT IS CONTINUANCE OF INCOME?

Continuance of income refers to the likelihood that a borrower's income will continue at its current level or higher for the foreseeable future, typically at least three years. Lenders want to ensure that borrowers have a stable and reliable source of income to make their mortgage payments on time and in full.

WHY IS CONTINUANCE OF INCOME IMPORTANT FOR SELF-EMPLOYED BORROWERS?

For self-employed borrowers, proving continuance of income can be more challenging compared to salaried employees. Self-employed individuals often experience fluctuations in their income due to the nature of their work, making it more difficult for lenders to assess their ability to maintain consistent mortgage payments. As a result, lenders may require additional documentation and verification to establish the continuance of income for self-employed borrowers.

HOW LENDERS EVALUATE CONTINUANCE OF INCOME FOR SELF-EMPLOYED BORROWERS

Lenders use various methods to evaluate the continuance of income for self-employed borrowers. Some of these methods include:

1. **Reviewing Tax Returns:** Lenders typically review the borrower's personal and business tax returns for the past two years to assess their income stability and growth trends. They may also look for any significant fluctuations or declines in income that could indicate potential issues with continuance.

2. **Analyzing Financial Statements:** Lenders may request financial statements, such as profit and loss statements and balance sheets, to gain a better understanding of the borrower's business performance and financial health.

3. **Evaluating Industry and Market Conditions:** Lenders may also consider the borrower's industry and market conditions to determine the likelihood of income continuance. For example, if the borrower's industry is experiencing rapid growth or is relatively stable, the lender may view their income as more likely to continue.

4. **Assessing Business Longevity:** Lenders often prefer borrowers with a longer history of self-employment, as this can indicate a higher likelihood of income continuance. Generally, a self-employed borrower with at least two years of experience in their field is considered more favorable.

TIPS FOR DEMONSTRATING CONTINUANCE OF INCOME

To improve your chances of mortgage approval as a self-employed borrower, consider the following tips for demonstrating continuance of income:

- Maintain accurate and up-to-date financial records, including tax returns, profit and loss statements, and balance sheets.
- Keep a consistent income level or show a steady upward trend in your earnings.
- Be prepared to provide additional documentation or explanations for any significant fluctuations or declines in your income.
- Work with a knowledgeable mortgage professional who understands the unique challenges faced by self-employed borrowers and can guide you through the mortgage process.

CONCLUSION

For self-employed borrowers, demonstrating continuance of income is a crucial aspect of the mortgage underwriting process. By understanding the importance of income continuance and taking steps to prove your income stability, you can

improve your chances of securing a mortgage and achieving your homeownership goals.

MODULE 3: INCOME TRENDS AND CASH FLOW ANALYSIS

ANALYZING INCOME TRENDS FOR SELF-EMPLOYED BORROWERS

INTRODUCTION

Understanding the income trends of self-employed borrowers is crucial for mortgage professionals and borrowers alike. This section will provide an overview of the importance of analyzing income trends and the key factors to consider when evaluating the financial stability of self-employed borrowers.

IMPORTANCE OF ANALYZING INCOME TRENDS

For self-employed borrowers, income trends play a significant role in the mortgage approval process. Lenders need to ensure that the borrower has a stable and consistent income to support the mortgage payments. Analyzing income trends helps lenders assess the borrower's financial stability and the likelihood of maintaining a consistent income in the future.

KEY FACTORS TO CONSIDER

When analyzing income trends for self-employed borrowers, mortgage professionals should consider the following factors:

1. **Length of Self-Employment**: The longer a borrower has been self-employed, the more likely they have a stable income. Lenders typically require a minimum of two years of self-employment to consider the borrower's income stable.

2. **Income Stability**: Lenders will look at the borrower's income over the past two years to determine if it has been stable or increasing. A stable or increasing income trend is favorable for mortgage approval.

3. **Industry Trends**: Lenders may also consider the overall health of the industry in which the borrower operates. A strong industry trend could indicate that the borrower's income is likely to remain stable or increase in the future.

4. **Seasonality:** Some self-employed borrowers may have seasonal fluctuations in their income. Lenders will need to analyze the borrower's income over a longer period to determine the stability of their income.

5. **Economic Factors:** External economic factors, such as market conditions and competition, can impact a borrower's income. Lenders should consider these factors when evaluating a borrower's income trends.

ANALYZING INCOME TRENDS: AN EXAMPLE

Let's consider a self-employed borrower who owns a small retail store. Over the past two years, their income has shown an upward trend. However, the retail industry has been facing challenges due to increasing competition from online retailers. In this case, the lender may want to further investigate the borrower's business strategy and plans for the future to ensure their income remains stable despite the industry challenges.

CONCLUSION

Analyzing income trends for self-employed borrowers is a crucial step in the mortgage approval process. By considering factors such as the length of self-employment, income stability, industry trends, seasonality, and economic factors, mortgage professionals can better assess the borrower's financial stability and likelihood of maintaining a consistent income in the future. This analysis will ultimately help both borrowers and lenders make informed decisions about mortgage approval.

MODULE 3: INCOME TRENDS AND CASH FLOW ANALYSIS

CASH FLOW ANALYSIS USING BANK STATEMENTS AND GROSS SALES RECEIPTS

In this section, we will discuss the importance of cash flow analysis for self-employed borrowers when applying for a mortgage. We will explore how to analyze bank statements and gross sales receipts to determine the borrower's income and cash flow.

IMPORTANCE OF CASH FLOW ANALYSIS

For self-employed borrowers, cash flow analysis is crucial in determining their ability to repay a mortgage. Unlike salaried employees, self-employed

individuals do not have a consistent paycheck, making it more challenging for lenders to assess their income stability. By analyzing cash flow, lenders can gain a better understanding of the borrower's financial situation and make an informed decision on whether to approve the mortgage application.

BANK STATEMENTS

Bank statements are a valuable source of information for lenders when analyzing a self-employed borrower's cash flow. They provide a detailed record of the borrower's financial transactions, including deposits, withdrawals, and transfers. Lenders typically require at least two years of bank statements to assess the borrower's income and cash flow.

When reviewing bank statements, lenders look for:

1. **Consistent deposits**: Regular deposits into the borrower's business or personal account indicate a stable income.
2. **Large deposits**: Lenders may require an explanation for any large deposits, as they could be a one-time occurrence and not indicative of consistent income.
3. **Recurring expenses**: Lenders will consider the borrower's recurring expenses, such as rent, utilities, and loan payments, to determine their debt-to-income ratio.

GROSS SALES RECEIPTS

Gross sales receipts are another essential tool for lenders when analyzing a self-employed borrower's cash flow. These receipts show the total revenue generated by the borrower's business before deducting any expenses. Lenders may request gross sales receipts for the past two years to assess the borrower's income trends and stability.

When analyzing gross sales receipts, lenders consider:

1. **Revenue trends**: Lenders will examine the borrower's revenue trends to determine if their income is stable, increasing, or decreasing. A stable or increasing trend is more favorable for mortgage approval.
2. **Seasonal fluctuations**: Some businesses experience seasonal fluctuations in revenue. Lenders will take this into account when assessing the borrower's income stability.
3. **Industry trends**: Lenders may also consider the overall trends in the borrower's industry to determine the likelihood of future income stability.

CONCLUSION

Cash flow analysis using bank statements and gross sales receipts is a critical component of the mortgage approval process for self-employed borrowers. By thoroughly analyzing these documents, lenders can better understand the

borrower's financial situation and make an informed decision about their ability to repay the mortgage. As a self-employed borrower, it is essential to maintain accurate and up-to-date financial records to improve your chances of mortgage approval.

MODULE 4: MORTGAGE UNDERWRITING GUIDELINES FOR SELF-EMPLOYED BORROWERS

B3-3.2-01: UNDERWRITING FACTORS AND DOCUMENTATION FOR A SELF-EMPLOYED BORROWER

INTRODUCTION

In this module, we will discuss the underwriting factors and documentation requirements that apply specifically to self-employed borrowers when applying for a mortgage. By understanding these factors, mortgage professionals can better serve their self-employed clients, and self-employed individuals can improve their chances of mortgage approval.

UNDERWRITING FACTORS FOR SELF-EMPLOYED BORROWERS

When underwriting a mortgage application for a self-employed borrower, lenders consider several factors to determine the borrower's ability to repay the loan. These factors include:

1. **Stability of Income**: Lenders look for a stable and consistent income from the borrower's business. They typically require at least two years of self-employment history to establish income stability.

2. **Continuance of Income**: Lenders need to be confident that the borrower's income will continue for at least three years after the mortgage application date. This is assessed by evaluating the borrower's industry, the demand for their products or services, and the financial strength of their business.

3. **Business Cash Flow**: Lenders analyze the borrower's business cash flow to determine if it is sufficient to support the borrower's personal financial obligations, including the proposed mortgage payment.

4. **Borrower's Personal and Business Income**: Lenders must analyze both the borrower's personal and business income to determine their ability to repay the mortgage. This includes evaluating the borrower's tax returns, financial statements, and other relevant documentation.

DOCUMENTATION REQUIREMENTS FOR SELF-EMPLOYED BORROWERS

To support their mortgage application, self-employed borrowers must provide various documents that demonstrate their income and financial stability. These documents may include:

1. **Personal Tax Returns**: Lenders typically require two years of personal tax returns, including all schedules and attachments, to verify the borrower's income.
2. **Business Tax Returns**: If the borrower's business is a separate legal entity, lenders may also require two years of business tax returns, including all schedules and attachments.
3. **Profit and Loss Statement**: A year-to-date profit and loss statement may be required to assess the borrower's current business income and expenses. This statement should be prepared by a certified public accountant (CPA) or the borrower themselves if they have adequate knowledge of accounting principles.
4. **Balance Sheet**: A current balance sheet may be required to evaluate the borrower's business assets, liabilities, and equity.
5. **Business License or Registration**: Lenders may request proof of the borrower's business license or registration to confirm the legitimacy of their business.
6. **Bank Statements**: Lenders may require the borrower's personal and/or business bank statements to verify their income and cash flow.
7. **Additional Documentation**: Depending on the borrower's specific situation, lenders may request additional documentation, such as a signed letter from a CPA, to support the mortgage application.

CONCLUSION

Understanding the underwriting factors and documentation requirements for self-employed borrowers is essential for mortgage professionals and self-

employed individuals seeking mortgage approval. By providing the necessary documentation and demonstrating a stable, consistent income and strong business cash flow, self-employed borrowers can improve their chances of obtaining a mortgage.

In the next module, we will explore different business structures and how they impact mortgage approval for self-employed borrowers.

MODULE 4: MORTGAGE UNDERWRITING GUIDELINES FOR SELF-EMPLOYED BORROWERS

KEY FACTORS TO CONSIDER FOR SELF-EMPLOYED BORROWERS

As a self-employed borrower, it's crucial to understand the factors that lenders consider when evaluating your mortgage application. In this section, we'll cover the key factors that underwriters look at when assessing self-employed borrowers for Fannie Mae and Freddie Mac mortgages.

1. LENGTH OF SELF-EMPLOYMENT

Lenders typically require a minimum of **two years** of self-employment history to establish a track record of stable income. However, exceptions can be made for borrowers with at least one year of self-employment, provided they have a history of related employment or can demonstrate sufficient income stability.

2. STABILITY OF INCOME

Stable income is essential for mortgage approval. Lenders want to see that your income is consistent and reliable. As a self-employed borrower, you'll need to provide documentation that demonstrates your income stability, such as:

- Tax returns for the past two years
- Year-to-date profit and loss statement
- Balance sheets

3. CONTINUANCE OF INCOME

Lenders want to ensure that your income will continue for at least **three years** after the loan is closed. To assess this, underwriters may consider factors such as:

- The demand for your products or services
- The financial strength of your business
- The stability of your income over time

4. DEBT-TO-INCOME (DTI) RATIO

Your DTI ratio is a critical factor in determining your ability to repay the mortgage. It is calculated by dividing your total monthly debt payments by your gross monthly income. Lenders typically prefer a DTI ratio of **43% or lower** for self-employed borrowers, although exceptions can be made depending on other compensating factors.

5. CREDIT SCORE

A good credit score is essential for mortgage approval. Lenders use your credit score to assess your creditworthiness and determine the interest rate on your loan. For Fannie Mae and Freddie Mac mortgages, the minimum credit score requirement is typically **620**.

6. DOWN PAYMENT AND RESERVES

A larger down payment can improve your chances of mortgage approval, as it reduces the lender's risk. Additionally, having sufficient cash reserves can demonstrate your ability to cover mortgage payments in case of income fluctuations. Lenders may require self-employed borrowers to have more significant reserves than salaried borrowers due to the potential for income volatility.

7. BUSINESS STRUCTURE

The structure of your business can impact your mortgage approval process. Lenders may require additional documentation depending on whether you operate as a sole proprietorship, partnership, limited liability company, S corporation, or corporation.

In conclusion, understanding these key factors can help you better prepare for the mortgage application process as a self-employed borrower. By demonstrating income stability, maintaining a low DTI ratio, and having a

strong credit score, you can improve your chances of securing a Fannie Mae or Freddie Mac mortgage.

MODULE 5: ANALYZING BUSINESS STRUCTURES AND THEIR IMPACT ON MORTGAGES

In this module, we will discuss the different types of business structures and how they affect mortgage approval for self-employed borrowers. Understanding the distinctions between these structures will help both mortgage professionals and self-employed individuals navigate the mortgage application process more effectively.

SOLE PROPRIETORSHIPS

A sole proprietorship is the simplest business structure, where the owner is the sole operator of the business and is personally responsible for all debts and liabilities. For mortgage purposes, the borrower's personal income and business income are considered the same. Lenders will typically require:

- Two years of personal tax returns, including Schedule C (Profit or Loss from Business)
- A year-to-date profit and loss statement

PARTNERSHIPS

In a partnership, two or more individuals share ownership and management responsibilities. Partnerships can be general or limited, with general partners having equal rights and responsibilities, while limited partners have limited liability and involvement. For mortgage purposes, lenders will require:

- Two years of personal tax returns, including Schedule E (Supplemental Income and Loss)
- Two years of partnership tax returns (Form 1065)
- A year-to-date profit and loss statement

LIMITED LIABILITY COMPANIES (LLCS)

An LLC is a hybrid business structure that combines the limited liability protection of a corporation with the tax benefits of a partnership. Owners are referred to as "members." For mortgage purposes, lenders will require:

- Two years of personal tax returns, including Schedule E (Supplemental Income and Loss) or Schedule C (Profit or Loss from Business) if the borrower is a single-member LLC
- Two years of LLC tax returns (Form 1065 or Form 1120S, depending on the LLC's tax classification)
- A year-to-date profit and loss statement

S CORPORATIONS

An S corporation is a type of corporation that allows for pass-through taxation, meaning the corporation's income, deductions, and credits flow through to shareholders for federal tax purposes. This structure avoids double taxation on corporate income. For mortgage purposes, lenders will require:

- Two years of personal tax returns, including Schedule E (Supplemental Income and Loss)
- Two years of S corporation tax returns (Form 1120S)
- A year-to-date profit and loss statement

CORPORATIONS

A corporation is a separate legal entity from its owners, providing limited liability protection and allowing for easy transfer of ownership. For mortgage purposes, lenders will require:

- Two years of personal tax returns
- Two years of corporate tax returns (Form 1120)
- A year-to-date profit and loss statement
- Documentation of the borrower's ownership percentage in the corporation

In conclusion, understanding the differences between various business structures and their impact on mortgage approval is crucial for both self-employed borrowers and mortgage professionals. By familiarizing yourself with the documentation requirements for each structure, you can better prepare for the mortgage application process and increase your chances of approval.

MODULE 5: ANALYZING BUSINESS STRUCTURES AND THEIR IMPACT ON MORTGAGES

HOW DIFFERENT BUSINESS STRUCTURES AFFECT MORTGAGE APPROVAL

In this section, we will explore the various types of business structures and how they can impact the mortgage approval process for self-employed borrowers. Understanding the differences between these structures can help both mortgage professionals and self-employed individuals navigate the mortgage application process more effectively.

SOLE PROPRIETORSHIPS

A sole proprietorship is the simplest business structure, where the owner and the business are considered the same legal entity. For mortgage approval purposes, lenders will typically look at the borrower's personal income tax returns (Form 1040) and Schedule C to determine the borrower's income.

Impact on Mortgage Approval:

- Income is reported on the borrower's personal tax returns, making it easier for lenders to assess income and tax liabilities.
- Lenders may require additional documentation, such as bank statements, to verify the consistency of income.

PARTNERSHIPS

In a partnership, two or more individuals share ownership of the business. Partnerships can be general or limited, with each partner's liability determined by the type of partnership. For mortgage approval, lenders will typically look at the borrower's personal income tax returns (Form 1040) and Schedule E, as well as the partnership's tax returns (Form 1065) and Schedule K-1.

Impact on Mortgage Approval:

- Lenders will need to review both personal and partnership tax returns to determine the borrower's income.
- The borrower's share of partnership income, losses, and liabilities may affect their debt-to-income ratio and overall mortgage eligibility.

LIMITED LIABILITY COMPANIES (LLCS)

An LLC is a hybrid business structure that combines the limited liability of a corporation with the tax flexibility of a partnership. For mortgage approval, lenders will typically look at the borrower's personal income tax returns (Form 1040) and Schedule E, as well as the LLC's tax returns (Form 1065) and Schedule K-1.

Impact on Mortgage Approval:

- Similar to partnerships, lenders will need to review both personal and LLC tax returns to determine the borrower's income.
- The borrower's share of LLC income, losses, and liabilities may affect their debt-to-income ratio and overall mortgage eligibility.

S CORPORATIONS

An S corporation is a type of corporation that passes income, losses, deductions, and credits through to its shareholders for tax purposes. For mortgage approval, lenders will typically look at the borrower's personal income tax returns (Form 1040) and Schedule E, as well as the S corporation's tax returns (Form 1120S) and Schedule K-1.

Impact on Mortgage Approval:

- Lenders will need to review both personal and S corporation tax returns to determine the borrower's income.
- The borrower's share of S corporation income, losses, and liabilities may affect their debt-to-income ratio and overall mortgage eligibility.

CORPORATIONS

A corporation is a legal entity separate from its owners, providing limited liability to its shareholders. For mortgage approval, lenders will typically look at the borrower's personal income tax returns (Form 1040) and any dividends received from the corporation (reported on Form 1099-DIV).

Impact on Mortgage Approval:

- Lenders will focus on the borrower's personal income and dividends received from the corporation.
- The borrower's ownership stake in the corporation may be considered an asset, but corporate income and liabilities generally do not impact the borrower's mortgage eligibility.

In conclusion, understanding the different business structures and how they affect mortgage approval is crucial for both mortgage professionals and self-employed individuals. By being aware of the various documentation requirements and potential impacts on debt-to-income ratios, borrowers can better prepare for the mortgage application process and improve their chances of approval.

MODULE 6: VERIFICATION OF INCOME AND ANALYSIS OF BORROWER'S PERSONAL AND BUSINESS INCOME

METHODS FOR VERIFYING SELF-EMPLOYED INCOME

One of the most critical aspects of the mortgage approval process for self-employed borrowers is verifying their income. Since self-employed individuals do not receive regular paychecks like traditional employees, mortgage lenders must rely on other methods to verify their income. In this section, we will discuss various methods for verifying self-employed income and how they impact the mortgage approval process.

1. TAX RETURNS

The most common method for verifying self-employed income is through tax returns. Lenders typically require two years of personal and business tax returns to assess the borrower's income stability and trends. These documents include:

- Form 1040: U.S. Individual Income Tax Return
- Schedule C: Profit or Loss from Business (Sole Proprietorship)
- Schedule E: Supplemental Income and Loss (Partnerships, S Corporations, and Rental Properties)
- Schedule K-1: Partner's Share of Income, Deductions, Credits, etc. (Partnerships and S Corporations)

Lenders will analyze these tax returns to calculate the borrower's average monthly income and determine their debt-to-income (DTI) ratio.

2. PROFIT AND LOSS STATEMENTS

In addition to tax returns, lenders may request a year-to-date (YTD) profit and loss (P&L) statement for the current year. This document provides an overview of the borrower's business income and expenses, allowing lenders to assess the borrower's financial performance and stability. The P&L statement should be prepared by a certified public accountant (CPA) or the borrower's tax professional.

3. BANK STATEMENTS

Some mortgage programs, such as bank statement loans, allow self-employed borrowers to verify their income using personal and business bank statements. Lenders will typically require 12 to 24 months of bank statements to analyze the borrower's cash flow and determine their average monthly income. This method is particularly useful for borrowers with fluctuating income or those who have difficulty documenting their income through traditional means.

4. BUSINESS LICENSES AND CONTRACTS

Lenders may also request copies of the borrower's business licenses, contracts, or other documentation to verify the legitimacy of their self-employment. These documents can help lenders confirm the borrower's business operations and income sources.

5. CPA OR TAX PROFESSIONAL LETTER

In some cases, lenders may request a letter from the borrower's CPA or tax professional to verify their self-employed income. This letter should include information about the borrower's business, income sources, and financial stability. It should also confirm that the borrower's tax returns and financial statements accurately represent their income.

In conclusion, verifying self-employed income is a crucial step in the mortgage approval process. Lenders use various methods, such as tax returns, profit and loss statements, bank statements, and professional letters, to assess the borrower's income stability and determine their eligibility for a mortgage. By understanding these methods and preparing the necessary documentation, self-employed borrowers can improve their chances of obtaining mortgage approval.

MODULE 6: VERIFICATION OF INCOME AND ANALYSIS OF BORROWER'S PERSONAL AND BUSINESS INCOME

ANALYZING PERSONAL AND BUSINESS INCOME FOR MORTGAGE APPROVAL

When it comes to mortgage approval for self-employed borrowers, both personal and business income play a crucial role in the underwriting process. In this section, we will discuss the importance of analyzing personal and business income and the factors that lenders consider during the mortgage approval process.

PERSONAL INCOME ANALYSIS

Personal income refers to the income that a self-employed borrower receives from their business. This income is used to determine the borrower's ability to repay the mortgage loan. Here are some factors that lenders consider when analyzing personal income:

1. **Consistency of Income**: Lenders prefer borrowers with a consistent income over time. They will review the borrower's tax returns, bank statements, and financial statements to determine the stability of their income.

2. **Debt-to-Income Ratio (DTI):** DTI is a crucial factor in the mortgage approval process. It is the percentage of a borrower's gross monthly income that goes towards paying debts. Lenders typically prefer a DTI ratio of 43% or lower.

3. **Residual Income:** Residual income is the amount of money left over after all monthly debts and obligations have been paid. Lenders may consider residual income as an additional factor in determining a borrower's ability to repay the mortgage.

BUSINESS INCOME ANALYSIS

Business income analysis is essential for self-employed borrowers because it helps lenders determine the stability and profitability of the borrower's

business. Here are some factors that lenders consider when analyzing business income:

1. **Business Profitability**: Lenders will review the borrower's profit and loss statements, balance sheets, and tax returns to determine the profitability of the business.
2. **Business Cash Flow**: Cash flow is a critical factor in determining the borrower's ability to repay the mortgage. Lenders will analyze the borrower's cash flow statements to ensure that the business generates enough cash to cover its expenses and the borrower's personal financial obligations.
3. **Business Debt Coverage Ratio (DCR)**: DCR is the ratio of a business's net operating income to its total debt service. A higher DCR indicates a lower risk for the lender, as it shows that the business can comfortably cover its debt obligations.
4. **Length of Time in Business**: Lenders prefer borrowers with a longer history of successful business operations. A longer time in business indicates stability and reduces the risk of default.

TIPS FOR IMPROVING PERSONAL AND BUSINESS INCOME ANALYSIS

Here are some tips for self-employed borrowers to improve their personal and business income analysis for mortgage approval:

1. **Maintain Accurate Financial Records**: Keeping accurate and up-to-date financial records is essential for self-employed borrowers. This will help lenders easily assess the borrower's personal and business income.
2. **Reduce Business Debt**: Reducing business debt can improve the borrower's DCR, making them more attractive to lenders.
3. **Increase Personal Income**: Increasing personal income through additional sources, such as a part-time job or freelance work, can help improve the borrower's DTI ratio and increase their chances of mortgage approval.
4. **Seek Professional Advice**: Consulting with a financial advisor or mortgage professional can provide valuable insights and guidance on how to improve personal and business income analysis for mortgage approval.

In conclusion, analyzing personal and business income is a crucial aspect of the mortgage approval process for self-employed borrowers. By understanding the factors that lenders consider and taking steps to improve their financial profile, self-employed borrowers can increase their chances of obtaining a mortgage loan.

MODULE 7: USE OF BUSINESS ASSETS AND INCOME VERIFICATION FOR SELF-EMPLOYED CO-BORROWERS

ASSESSING THE IMPACT OF USING BUSINESS ASSETS FOR DOWN PAYMENT, CLOSING COSTS, AND RESERVES

When it comes to mortgage approval, self-employed borrowers often face unique challenges. One such challenge is the use of business assets for down payment, closing costs, and reserves. In this section, we will discuss how using business assets can impact the mortgage approval process for self-employed borrowers and co-borrowers.

USING BUSINESS ASSETS FOR DOWN PAYMENT

A down payment is an essential part of the mortgage process, as it demonstrates the borrower's commitment to the property and reduces the lender's risk. For self-employed borrowers, using business assets for the down payment can be a viable option. However, it is important to consider the following factors:

1. **Documentation**: Lenders will require documentation to verify the source of the down payment funds. This may include bank statements, profit and loss statements, and balance sheets. Be prepared to provide these documents to your lender.

2. **Impact on Business**: Withdrawing a significant amount of money from your business for a down payment can have an impact on your business's financial stability. Lenders will want to ensure that your business can continue to operate successfully after the withdrawal.

3. **Loan-to-Value Ratio (LTV)**: Using business assets for the down payment may affect the loan-to-value ratio, which is the percentage of the loan

amount compared to the property's value. A higher LTV may result in higher interest rates or additional mortgage insurance requirements.

USING BUSINESS ASSETS FOR CLOSING COSTS

Closing costs are fees and expenses associated with finalizing a mortgage, such as appraisal fees, title insurance, and origination fees. Self-employed borrowers may also use business assets to cover these costs. However, similar to using business assets for down payment, lenders will require documentation and assess the impact on the business.

USING BUSINESS ASSETS FOR RESERVES

Reserves are funds set aside by the borrower to cover mortgage payments in case of financial hardship. Lenders may require self-employed borrowers to have a certain amount of reserves as a precaution. Using business assets for reserves can be an option, but borrowers should consider the following:

1. **Impact on Business**: As with using business assets for down payment and closing costs, using business assets for reserves can impact the financial stability of the business. Lenders will want to ensure that the business can continue to operate successfully after the withdrawal.

2. **Reserve Requirements**: Lenders may have specific reserve requirements for self-employed borrowers. Be prepared to discuss these requirements with your lender and provide documentation to verify the source of the reserve funds.

In conclusion, using business assets for down payment, closing costs, and reserves can be a viable option for self-employed borrowers and co-borrowers. However, it is essential to consider the impact on the business and be prepared to provide documentation to satisfy lender requirements. In the next section, we will discuss income verification requirements for self-employed co-borrowers.

MODULE 7: USE OF BUSINESS ASSETS AND INCOME VERIFICATION FOR SELF-EMPLOYED CO-BORROWERS

INCOME VERIFICATION REQUIREMENTS FOR SELF-EMPLOYED CO-BORROWERS

When a self-employed individual applies for a mortgage with a co-borrower, it's important to understand the income verification requirements for both parties. In this section, we will discuss the necessary documentation and verification processes for self-employed co-borrowers.

DOCUMENTATION REQUIREMENTS

Self-employed co-borrowers must provide the following documentation to verify their income:

1. **Personal Tax Returns:** The most recent two years of personal tax returns, including all schedules and attachments, are required for self-employed co-borrowers. This helps lenders assess the borrower's income stability and trends.

2. **Business Tax Returns:** If the co-borrower owns 25% or more of a business, they must also provide the most recent two years of business tax returns, including all schedules and attachments. This allows lenders to analyze the business's financial health and profitability.

3. **Year-to-Date Profit and Loss Statement (P&L):** A current, year-to-date P&L statement is necessary to show the co-borrower's income for the current year. This helps lenders determine if the borrower's income is consistent with previous years.

4. **Balance Sheet:** A current balance sheet is required to provide a snapshot of the co-borrower's business assets, liabilities, and equity. This helps lenders assess the borrower's overall financial position.

VERIFICATION PROCESS

The lender will use the provided documentation to verify the co-borrower's income in the following ways:

1. **Income Analysis:** Lenders will analyze the co-borrower's personal and business tax returns to calculate their qualifying income. This may include adjustments for non-cash expenses, such as depreciation and depletion, to determine the borrower's true cash flow.

2. **Comparative Analysis:** Lenders will compare the co-borrower's year-to-date income with previous years to identify any significant fluctuations or

trends. This helps determine if the borrower's income is stable and likely to continue.

3. **Business Health Assessment:** By reviewing the co-borrower's business tax returns, P&L statement, and balance sheet, lenders can assess the overall health and profitability of the business. This helps determine if the borrower's income source is stable and reliable.

4. **Debt-to-Income (DTI) Ratio Calculation:** Lenders will calculate the co-borrower's DTI ratio by dividing their total monthly debt payments by their gross monthly income. This ratio helps lenders determine if the co-borrower can afford the mortgage payment and other monthly obligations.

KEY TAKEAWAYS

- Self-employed co-borrowers must provide personal and business tax returns, a year-to-date P&L statement, and a balance sheet to verify their income.
- Lenders will analyze the co-borrower's documentation to assess their income stability, business health, and ability to afford the mortgage payment.
- Understanding the income verification requirements for self-employed co-borrowers can help improve their chances of mortgage approval.

In the next section, we will recap the key concepts and guidelines covered in this course and provide additional resources for further learning and assistance.

MODULE 8: CONCLUSION AND ADDITIONAL RESOURCES

RECAP OF KEY CONCEPTS AND GUIDELINES

In this course, we have covered various aspects of self-employed borrowers and Fannie Mae and Freddie Mac mortgages. Let's take a moment to recap the key concepts and guidelines we have discussed throughout the course.

1. OVERVIEW OF FANNIE MAE AND FREDDIE MAC MORTGAGES

Fannie Mae and Freddie Mac are government-sponsored entities (GSEs) that provide liquidity and stability to the mortgage market by purchasing and guaranteeing mortgages. They have specific guidelines for self-employed borrowers to ensure that they can afford the mortgage payments.

2. CONSISTENCY AND CONTINUANCE OF INCOME

Income stability and continuance of income are crucial factors in mortgage approval for self-employed borrowers. Lenders need to ensure that the borrower's income is consistent and likely to continue for at least three years.

3. INCOME TRENDS AND CASH FLOW ANALYSIS

Analyzing income trends and cash flow is essential for self-employed borrowers. Lenders will assess the borrower's income stability by reviewing their bank statements, gross sales receipts, and other financial documents.

4. MORTGAGE UNDERWRITING GUIDELINES FOR SELF-EMPLOYED BORROWERS

Fannie Mae and Freddie Mac have specific underwriting guidelines for self-employed borrowers, including B3-3.2-01: Underwriting Factors and Documentation for a Self-Employed Borrower. These guidelines help lenders evaluate the borrower's eligibility for a mortgage.

5. ANALYZING BUSINESS STRUCTURES AND THEIR IMPACT ON MORTGAGES

Different business structures, such as sole proprietorships, partnerships, limited liability companies, S corporations, and corporations, can affect mortgage approval for self-employed borrowers. Lenders need to understand how these structures impact the borrower's income and financial stability.

6. VERIFICATION OF INCOME AND ANALYSIS OF BORROWER'S PERSONAL AND BUSINESS INCOME

Lenders must verify the self-employed borrower's income using various methods, such as tax returns, financial statements, and bank statements. They will also analyze the borrower's personal and business income to determine their ability to repay the mortgage.

7. USE OF BUSINESS ASSETS AND INCOME VERIFICATION FOR SELF-EMPLOYED CO-BORROWERS

Using business assets for down payment, closing costs, and reserves can impact mortgage approval for self-employed borrowers. Additionally, lenders must verify the income of self-employed co-borrowers to ensure they can contribute to the mortgage payments.

ADDITIONAL RESOURCES

For further learning and assistance, consider the following resources:

1. Fannie Mae Selling Guide - A comprehensive guide on Fannie Mae's mortgage underwriting guidelines and requirements.
2. Freddie Mac Seller/Servicer Guide - A detailed guide on Freddie Mac's mortgage underwriting guidelines and requirements.
3. Consumer Financial Protection Bureau (CFPB) - A government agency that provides information and resources to help consumers understand mortgages and other financial products.
4. National Association of Mortgage Brokers (NAMB) - A professional organization that offers resources and support for mortgage professionals.
5. Small Business Administration (SBA) - A government agency that provides resources and support for small business owners, including information on financing options.

By understanding the key concepts and guidelines discussed in this course, mortgage professionals can better serve self-employed borrowers, and self-employed individuals can improve their chances of mortgage approval.