

# What's Trending in MPF® Quality Control

June 2020



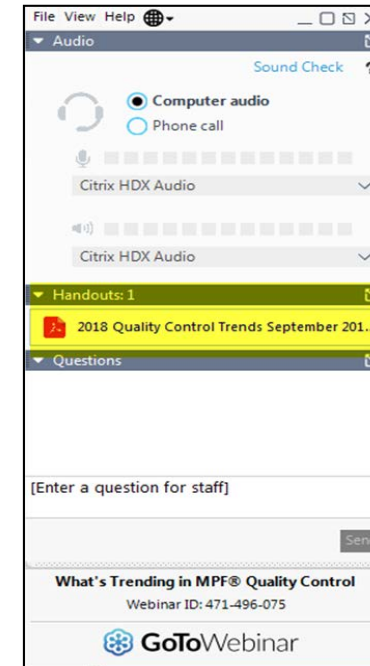
**FHLBANKS**  
A NATION OF LOCAL LENDERS



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# Topics

- MPF Quality Control
- COVID-19 Reminders
- Liabilities
- Assets
- Gifts
- Funds to Close
- Employment/Income
- Occupancy
- Appraisals
- Best Practices



# MPF Quality Control

## MPF Quality Control Sampling Methodology

- MPF Program loan files are sampled based on a rate of the lesser of four loans or 10% of your volume over a rolling 12-month period.
- At least one loan per year will be reviewed.
- These requirements do not include any high-risk overlays that may be reviewed or any loans selected by the Federal Home Loan Bank.





# Using eMAQCS

**Help us help you!**

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

**How many QC file reviews have been  
completed year to date?**

**2835**

**R E V I E W**



# COVID-19 Quality Control Reminders

## Temporary Origination Guidelines were issued beginning March 23<sup>rd</sup>, 2020

- Temporary loan origination requirements are currently in effect until July 31, 2020.
- As of this training date, MPF Traditional loans should comply with the requirements and updates published in MPF Announcement 2020-37.
- MPF Xtra loans should comply with announcements published by Fannie Mae
- MPF Government loans and MPF Government MBS should comply with the requirements published by each applicable agency (i.e. FHA, VA, RHS).
- In addition, PFIs are required to abide by any/all federal or state laws or proclamations that may affect borrowers or loans affected by COVID-19.

# COVID-19 Quality Control Reminders

## Permitted Verbal Verification of Employment Alternatives

- **A written VOE** confirming the borrower's current employment status within the same timeframe as the verbal VOE requirements is permitted.
  - ✓ An email directly from the employer that identifies the name and title of the verifier and the borrower's name and current employment status may be used in lieu of a verbal VOE.
  - ✓ A VOE obtained after loan closing up to the time of loan delivery is acceptable.
  - ✓ Obtaining a verbal VOE before the note date is still strongly encouraged.
- **A year-to-date paystub** from the pay period that immediately precedes the note date may be used.
- **Bank statements** (or other alternative documentation per MPF Selling Guides) evidencing the payroll deposit from the pay period that immediately precedes the note date.

# COVID-19 Quality Control Reminders

## Self Employed Borrowers

- Evidence that the business is still operating and if so, additional steps must be taken to document the current level of income.
  - ✓ Confirm within ten days of closing or after closing as long as it prior to loan delivery.
- Audited year-to-date profit and loss statements should be used to determine if COVID-19 has had an impact on the business.
- In the event an audited statement is not available, an unaudited statement is permitted with two months of recent business account statements.

# COVID-19 Quality Control Reminders

## General Reminders

- The age of income and asset documentation has been reduced from 120 to 60 days.
- Because market-based assets (i.e. mutual funds, stocks or stock options) are highly volatile, proof of liquidation is required when used for down payment and/or closing costs.
- If market-based assets are used as reserves, 70% of the value should be used for qualifying.



# Common QC Findings

# 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

## How to Avoid Undisclosed Debt Complications

- **Prevention starts with the Loan Officer/Originator.**
  - ✓ Educate the borrower at the time of application.
  - ✓ Most borrowers are unaware of the impact, especially after their loan has been “approved”.
- **Follow-up on credit inquiries.**
  - ✓ MPF Traditional (manual underwriting) guidelines state that all inquiries made in the past 90 days must have a detailed explanation from the *inquirer* that addresses both the purpose and outcome of the inquiry.
  - ✓ MPF Xtra® and MPF Traditional loans underwritten with an Automated Underwriting System (AUS) guidelines are a bit more vague and state that the lender “must confirm that the borrower has not obtained any additional credit that is not listed on the credit report”.
- **Obtain a “soft-pull” credit report before closing.**
  - ✓ Does not effect the borrower’s credit score.

# 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 Desktop Underwriter® (DU®) or Loan Product Advisor® (LPA) the applicable tolerances for resubmission must be followed.



# DU Resubmission Scenario Quiz

Discovery of new debt results in the DTI ratio increasing from 35% to 40%

**RESUBMISSION REQUIRED**

Discovery of new debt results in the DTI ratio increasing from 46% to 48%

**RESUBMISSION NOT REQUIRED**

Discovery of new debt results in the DTI ratio increasing from 44% to 46%

**RESUBMISSION REQUIRED**

LPA/Freddie Mac requires resubmission if the DTI ratio increases by more than three percentage points and if the total DTI ratio on the previous submission exceeded 45%.

# Incorrect Liabilities

The liabilities on the credit report do not match what is on the 1003/1008

- We are missing an explanation or documentation to support the omission.
  - ✓ Recently paid off? – needs documenting
  - ✓ Less than 10 payments on an installment debt but shows more?
    - ***While the 10 payments is counted from the closing date, we suggest getting a credit supplement before closing to reflect that there are 10 or less payments remaining.***
  - ✓ Watch for duplicate items or items that look like duplicates but are not.
  - ✓ Not the borrower's debt? – needs documenting
  - ✓ If paid by a business, provide evidence
  - ✓ Do not omit car lease payments with less than 10 payments remaining

1 Description: The borrower's credit was not sufficiently documented. A monthly installment payment in the amount of \$497 was omitted from the borrower's DTI ratio; however, no documentation was provided to support this exclusion. Please refer to DU condition 9. Type: Documentation

Resolution: Please provide documentation to support the exclusion of the installment loan of \$497 from the borrower's qualifying DTI ratio.

# Cash on Hand

**If manually underwriting a MPF Traditional loan, cash on hand is an acceptable source of borrower funds if the following requirements are met:**

- The amount of cash on hand is consistent with the borrower's income and employment.
- The borrower has a history of paying cash; and the borrower has a limited credit history with no checking or savings accounts.

**Under the MPF Xtra product or if a MPF Traditional loan is underwritten with DU or LPA, cash is not an acceptable source of funds.**

**Cash on hand is permitted under Fannie Mae's HomeReady® option.**

# Asset Verification

## Unsourced Assets

- Large deposits shown bank statements or funds to open a new account are not properly sourced.

**QC has discovered funds that came from sources such as unsecured loans and cash on hand.**

- Any indication of borrowed funds should be investigated.
  - ✓ A recently opened account.
  - ✓ Large deposits (greater than 50% of the total monthly qualifying income).
  - ✓ An account balance that is considerably greater than the average balance over the previous few months.

**1** Description: Documentation verifying source of funds for \$7,000 deposit from 5/17/18 reflected on bank statement is missing from the loan file.

Resolution: Please provide documentation to support source of funds for the noted deposit.



# Asset Verification

## Sourcing Funds

- If an account was opened recently (last two-three months), where did the funds to open the account originate?
- If there's a large deposit identified in any verified account, where did it come from?
  - ✓ If money was transferred from a verified account into another account (large deposit) or used to open a new account, verify the withdrawal from the account to make sure the funds are not counted twice.



# Gifts

## Who Can Provide Gifts?

- Relatives
  - ✓ Spouse
  - ✓ Parent
  - ✓ Child
  - ✓ Other dependent
  - ✓ Other individual related by blood, marriage, adoption or legal guardianship
  - ✓ Fiancé or Fiancée
  - ✓ Domestic Partner
- Established non-profit organizations
- Municipalities
- Employers



# Gift Funds

## If gift funds are received...

There are many instances of donor funds not being evidenced in the file.

Before Verifying Assets	After Verifying Assets	At Closing
<p>Verify that funds have been transferred into the account.</p> <ul style="list-style-type: none"><li>Cancelled <b>donor's check</b></li><li>Evidence of deposit</li></ul> <p>or</p> <ul style="list-style-type: none"><li>Evidence of electronic transfer between the donor and the borrower's account.</li></ul>	<p>Document the transfer of funds into the borrower's account.</p> <ul style="list-style-type: none"><li>Copy of the <b>donor's check</b> and <b>borrower's deposit slip</b>.</li></ul> <p>or</p> <ul style="list-style-type: none"><li>Copy of the <b>donor's withdrawal slip</b> and <b>borrower's deposit slip</b></li><li>or</li><li>Evidence of electronic transfer between the donor and the borrower's account.</li></ul>	<p>Funds must be in the form of a certified check, cashier's check, other official check or wire transfer (must show donor as remitter).</p> <ul style="list-style-type: none"><li>Copy of the <b>donor's check</b> to the closing agent or evidence of wire transfer.</li><li>A Closing Disclosure (CD) showing receipt of the <b>donor's check/funds</b>.</li></ul>

# Gift Funds

## Minimum Borrower Contribution

LTV/CLTV	1 Unit Primary	2-4 Unit Primary	Second Home
> 80% LTV/CLTV	All funds may come from a gift	5% must come from borrower's own funds	5% must come from borrower's own funds
≤ 80% LTV/CLTV	All funds may come from a gift	All funds may come from a gift	All funds may come from a gift

If incorporating down payment assistance funds into a transaction, be watchful of possible minimum borrower contribution requirements set by the DPA provider.

Affordable housing grants must be entered into the AUS as a community second for the TLTV to calculate correctly.

# Employment

## Employed or Not Employed?

- A number of instances have been identified where a borrower is unemployed at the time of closing.
- Can be difficult to determine.
  - ✓ Try doing verbal VOEs closer to closing.
  - ✓ Emphasize that the 1003 signed at closing should accurately reflect their current situation.
  - ✓ If anything seems suspicious, ask questions!



# Declining Income

## Self-employed borrowers with declining income

- If the trend in the amount of income is stable or increasing, the income amount should be averaged.\*
- If the trend was declining, but has since stabilized and there is no reason to believe that the borrower will not continue to be employed at the current level, the current, lower amount of variable income must be used.
  - ✓ Example: If there was a decline from 2016 to 2017 and 2018 seems to be back on track, use 2017 income only.
  - ✓ If there is a legitimate one-time expense (due to a natural disaster, equipment purchase, etc.) that expense should be noted in the file.
- If the trend is declining, the income may not be stable. Additional analysis must be conducted to determine if any variable income should be used, but in no instance may it be averaged over the period when the declination occurred.
  - ✓ If 2016, 2017 and YTD 2018 are all declining and the lowest amount is enough to qualify, this still represents a problem.
  - ✓ While adequate, it is not stable.

*\*Sometimes DU or LPA may only require one year of returns.*



# Omitting Income or Losses

**Analysis of self-employed income or loss is not required when the self-employment income is secondary or a separate income source.**

- The Borrower must qualify using their primary source of income, that income **may not be derived from self-employment**.
- Self-employment income or loss for a co-borrower does not have to be considered.
- Income or losses reflected on IRS Schedule F (Farming Income) does not have to be considered.

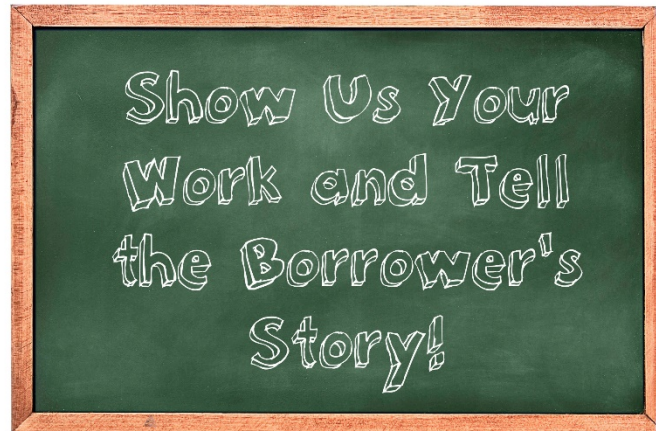


- If self-employment is the primary source of qualifying income, ALL other self-employed income or losses must be considered.

# Tell the Story

**Written explanations are a valuable tool to help avoid QC findings.**

- Show income calculations
- Use of an income calculation worksheet is advised
- Income calculations can be explained on a 1008 or on a separate document.
- Borrower letters of explanation may also help reviewer understand a situation.



# Self-Employed Income Analysis

## Popular Worksheets

Fannie Mae: [https://www.fanniemae.com/content/guide\\_form/1084.pdf](https://www.fanniemae.com/content/guide_form/1084.pdf)

Freddie Mac: <http://www.freddiemac.com/singlefamily/forms/sell/pdf/91.pdf>

MGIC: <https://www.mgic.com/underwriting/seb>

ARCH MI: <https://mi.archcapgroup.com/Calculators>

Genworth: <https://new.mi.genworth.com/self-employed-borrower-calculators>

Radian: <https://www.radian.biz/apex/page?name=SelfEmployedCFAnalyzer>

Essent: <https://www.essent.us/training/essentials-training/income-analysis-tools>

# Occupancy

## Difficulty determining occupancy status

- Extra care must be taken when borrowers decide to keep a departure residence as a rental.
- Watch for signs that the new property may not be a primary residence:
  - ✓ What's the distance from the departure residence?
  - ✓ Does the size of the property make sense for the borrower's lifestyle?
  - ✓ Look at the insurance coverage, does it show rental property (or landlord) insurance?



# Occupancy

## Difficulty Determining Occupancy Status

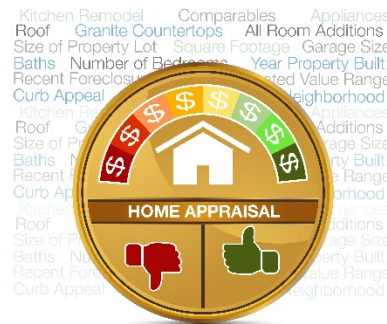
- If our QC vendor cannot verify occupancy, we will want to obtain some type of non-essential utility bill (i.e. cable, internet, landline phone) to confirm occupancy.
  - ✓ Many essential utilities like heat and electricity are not a good indicator of occupancy because they may only show the property address not the borrower's true mailing address.
  - ✓ An essential utility bill may be in the borrower's name at the subject property while the property is being renovated.
  - ✓ Bank statements are discouraged because addresses are easily changed.



# Appraisals

**Appraisal issues have improved but a few interesting issues have been noticed.**

- There have been some issues with values increasing substantially in a short period of time.
  - ✓ Appraisers should address these issues to help understand the sudden increase.
- Appraisals are being submitted subject to completion without evidence of a final inspection (Fannie Mae Form 1004D or Freddie Mac Form 442).
- Form 1004MC (Market Conditions Addendum) is no longer required.





# Appraisals

**While a value may be supported and a property may appear normal, always be sure to read all appraiser comments.**

The new addition is radiant heat that is heated by the outdoor wood burner. The 1st floor of the 2 story is heated by a truck radiator also heated by the outdoor wood stove. The second story is heated by gravity heat with vents in the floor to allow heat flow from the 1st floor. There is a furnace that has never been used by the owner that is believed to be heated by oil (not in use and not hooked up to duct work). There is some electric baseboard in the living room. The outdoor wood burner is the main heat source. There has been an adjustment made on the grid for this condition. Outdoor wood stoves are not uncommon in the area, most dwellings that are full time residences have a central heating source that can be used as a backup when the wood stove is not in use.

Per the Owner the well is shallow (may be hand dug) but has never run dry. This is not uncommon in the area and generally accepted by the market.

The basement of the subject has a dirt floor; the comparable basements may have been cemented but with a vapor barrier, the market does not have a strong reaction to this factor, however, a small adjustment was made as to the estimated cost of a vapor barrier to be added.

Hmmmm.....

# Appraisals

**If a property has an unusual feature, make sure the appraiser provides comments about what makes it unique.**

Describe the condition of the property (including needed repairs, deterioration, renovations, remodeling, etc.). C2;No updates in the prior 15 years;Subject is a new metal pole barn constructed home and garage 40x60. Materials and workmanship are above average. There are a few minor unfinished interior items, mainly kitchen counter tops, window and door trim, and generator has not been installed (value estimate completed "as is").

Does the property generally conform to the neighborhood (functional utility, style, condition, use, construction, etc.)? ☐ Yes ☒ No If No, describe  
The subject is a pole-barn-styled home. This style of home, while not completely unique in rural areas in this wider market area, is not considered a typical style and does exhibit a small amount of negative market reaction.

The comparable sales selected were the best and most recent available to your appraiser. They are all located on small acreage in the wider area. As is typical in rural areas, new homes tend to be custom built and rarely resell. Thus, all the available sales were of older homes and required significant condition adjustments. The subject is also unusual in style. There are other homes similar in style in the wider area, but they also tend to be custom built and rarely resell. No otherwise competitive sales with similar style were available. In the subject's rural residential setting large garages/outbuildings are desirable and have considerable contributory value.



# Some Final Extras

## Departure Residence Obligations

- Missing documentation that provides the amount of taxes and insurance included in the DTI.
- Missing evidence that taxes and insurance are escrowed and included in mortgage payment.

## New Construction

- Failure to provide documentation of an “as-improved” property tax amount and evidence it was used for qualification.
  - ✓ This is to ensure the borrower is not faced with payment shock when the home is fully assessed.
  - ✓ Resources to estimate as-improved tax levels vary but may include options such as the county assessor’s office/website, settlement agents, and public websites such as <https://smartasset.com>.

# Pre-Funding Best Practices

**Many things can occur just before closing that result in changes in the loan amount, such as payoff differences or a change in the down payment.**

- This may require redrawing the closing documents or possibly re-underwriting the loan.
- Sometimes payoff amounts on refinances are larger than estimated- does the borrower need to bring funds to closing and were those funds verified?
- Changes may occur at many points during processing of a loan that might alter the terms of the transaction.
  - ✓ Never assume the underwriting team is aware of a change-always inform and secure the necessary approvals.
  - ✓ Closing is time-sensitive and pressure-filled, provide the closer with sufficient time to make an accurate assessment as well as the authority to stop or delay closing to get it right.
  - ✓ Limiting items to be collected at closing may help reduce errors.

# Pre-Closing Best Practices

- Obtain IRS tax transcripts before underwriting (if applicable) for the borrower's income type.
- Always use a red flag checklists for appraisals.
- Repeat the verbal verification of employment the day before or day of closing.
- Clear the credit report and other fraud alerts prior to loan approval.
- Always obtain proof of liquidation (when required) of the assets that are to be used as funds to close.



# And Remember...

When sending scanned documents, try to make sure they are legible!

**APPLICANT**

**JO-APPLICANT**

NAME: [REDACTED] SSN: [REDACTED] DOB: [REDACTED] MARRIAGE: [REDACTED]

CURRENT ADDRESS: [REDACTED] PREVIOUS ADDRESSES: [REDACTED]

EMPLOYMENT: [REDACTED] INCOME: [REDACTED] CREDIT: [REDACTED]

MORTGAGE: [REDACTED] RENTAL: [REDACTED] SALES: [REDACTED]

INVESTMENTS: [REDACTED] ASSETS: [REDACTED] LIABILITIES: [REDACTED]

CREDIT HISTORY: [REDACTED] CREDIT SCORE: [REDACTED] CREDIT REPORT: [REDACTED]

CREDIT REVIEW: [REDACTED] CREDIT REVIEW NOTES: [REDACTED] CREDIT REVIEW DATE: [REDACTED]

CREDIT REVIEW BY: [REDACTED] CREDIT REVIEW COMMENTS: [REDACTED] CREDIT REVIEW SIGNATURE: [REDACTED]

# MPF Contacts and Resources

## MPF Service Center

Email - [MPF-Help@FHLBC.com](mailto:MPF-Help@FHLBC.com)

Hours - 8:30 am to 4:30 pm CST

Phone: (877) 463-6673

## MPF Quality Control

[mpfinvestordirectqc.fhlbc.com](mailto:mpfinvestordirectqc.fhlbc.com)





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