

# What's Trending in MPF® Quality Control

March 2022



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# Agenda

- **Critical Defects**
- **Income Calculations and Employment**
- **Liabilities**
- **Assets**
- **Miscellaneous**
- **Best Practices**



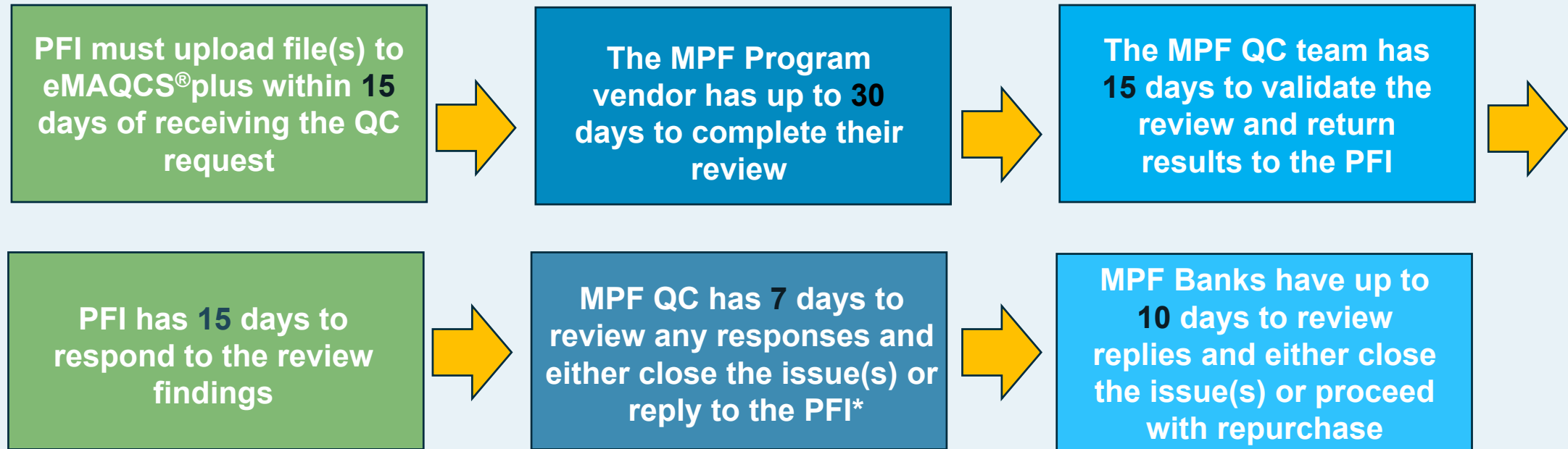
# MPF Quality Control

## 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.

The logo for eMAQCSplus is displayed within a white rectangular box with a thin black border. The text 'eMAQCS' is in a bold, dark blue sans-serif font, while 'plus' is in a lighter blue sans-serif font with a horizontal line underneath the 's'.

# 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. The PFI 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.*



# 4506-C Requirements

Which of the following about tax transcript requirements is true?

- a. Two years of federal tax return transcripts are always required.
- b. Tax transcripts must be used to underwrite the file.
- c. Tax transcripts must be in all loan files requested for QC reviews.
- d. A completed 4506-C must be in the file so that the tax transcripts can be requested by the QC reviewer.

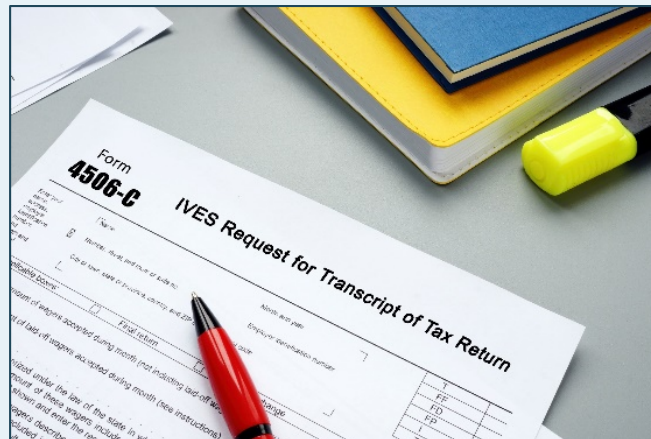


- a. **The answer is c. All files requested for QC reviews must contain transcripts of the tax return documents used to underwrite the file.**

# Tax Transcripts

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

- Transcripts are not required 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 *prior* to a possible QC review.
- Loans underwritten with **DU using Day 1 Certainty®** vendor documentation do not have to provide transcripts or a 4506-C.



# 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  
Do not file this form unless the corporation has filed or is  
attaching Form 2553 to elect to be an S corporation.  
Instructions for Form 1120S and its separate instructions is at [www.irs.gov/fo](http://www.irs.gov/fo)

Form **1120S**  
Department of the Treasury  
Internal Revenue Service  
For calendar year 2015 or tax year beginning

A S election effective date

TYPE OR PRINT

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 you have a tax year? ☐ Yes ☐ No If "No," attach Form 2553



# Critical Defects

How many files do you think the QC staff have reviewed year-to-date?

991

How many critical exceptions?

5



Let's look at the most common critical exceptions...

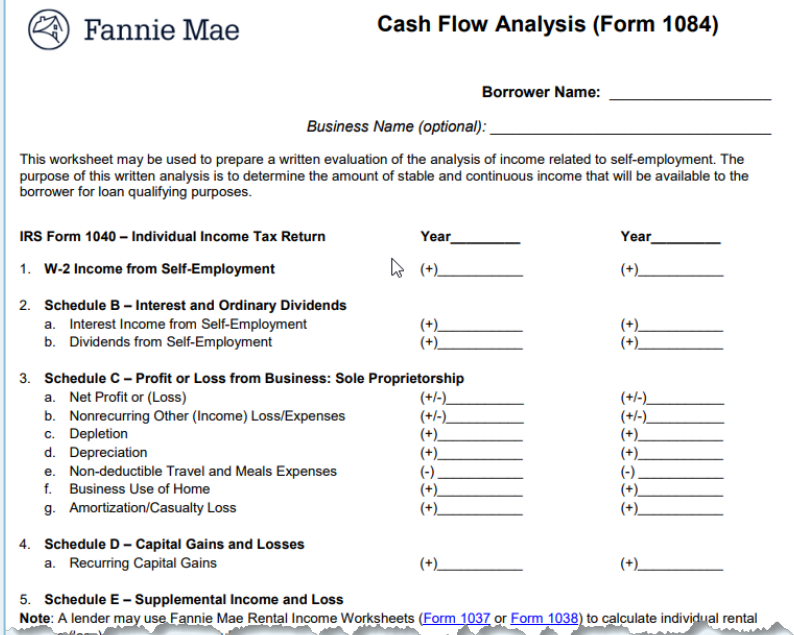
# Income Calculations and Employment



# 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.



**Fannie Mae** **Cash Flow Analysis (Form 1084)**

Borrower Name: \_\_\_\_\_

Business Name (optional): \_\_\_\_\_

This worksheet may be used to prepare a written evaluation of the analysis of income related to self-employment. The purpose of this written analysis is to determine the amount of stable and continuous income that will be available to the borrower for loan qualifying purposes.

IRS Form 1040 – Individual Income Tax Return	Year _____	Year _____
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

# Using Worksheets

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

Income Calculation Worksheet									
Borrower Name				Loan Number					
Employer				Date		3/17/2022			
Pay Type									
Hourly									
		Per Hour		0		# of hours		X52/12	
\$ -		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 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			
<input type="checkbox"/>		W2 income		0		# months			
<input type="checkbox"/>		W2 Income		0		# months			
		\$ - 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			
\$ -		Past year OT breakout		0		# months			
\$ -		Additional year OT / Bonus		0		# months			

# Using Worksheets

**4 Description:** Audit calculation of income was \$1,585.69 resulting in a DTI of 88.35% due to the borrower's YTD earnings not supporting the income of \$3,683.00 that was used to qualify.

**Resolution:** Please provide evidence the borrower was earning the income used to qualify. If the borrower receives commission income, provide a 2 year history of the borrower earning commission. The loan is not eligible with a DTI of 88.35%.

- When borrowers have variable sources of income like overtime, commissions or bonuses (which this one did), the income history must be examined.
- In this situation there was no 2019 W2 in the file (only 2020 and YTD paystub). Also, there was a COVID-related pay gap that was not mentioned in the file nor was there any sort of worksheet to explain the qualifying income of \$3,683..



# Income Trends

## Watch for income trends for both self-employed borrowers and borrowers who receive variable 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**.
  - ✓ If there was a legitimate one-time expense (due to a natural disaster, equipment purchase, etc.) that expense should be noted in the file.
- Declining income with no indication of stabilization should not be used.

# Documentation Question

**Amy applied for a loan on March 14, 2022. She is self-employed and provided her 2019 and 2020 tax returns.**  
**What else should Amy provide?**

- a. An audited 2021 P&L statement.
- b. An unaudited 2021 P&L statement plus the last 3 months business bank statements.
- c. If DU requires just the last two years, then nothing more.
- d. An unaudited 2021 P&L statement.

**Both c. and d. would be correct answers.**

If the most recent tax return is for the tax year 2020 or later, P&Ls and bank statements are no longer required unless noted in your AUS findings.



HOWEVER, a P&L statement and/or balance sheet, may be also be necessary or wanted to further support the stability of the borrower's income (best practice).

# Employed or Not Employed?

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

- Employment should be confirmed within 10 days (or less) of closing or after closing as long as it is 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

# Retirement Accounts

## Yes or No?

**Craig and Patricia have multiple IRAs. Some of the IRAs do not appear to support a three-year continuance. Can all of their IRA accounts be combined to meet the three-year requirement?**

**Yes.**

**Simply add up the IRA balances and divide by 36.**

**Example:** IRA balances of \$50,000 and \$20,000 both have \$1,000 monthly distributions.

$\$70,000 \div 36 = \$1,944.44$  Use that amount to qualify instead of \$2,000.

**Note:** The borrower must have unrestricted access to the accounts without penalty.





# Variable Income Calculations

**We see a number of issues with calculations involving variable income and the frequency of payments:**

- It's important to determine the frequency of the payment (weekly, biweekly, monthly, quarterly, or annually) to arrive at an accurate calculation.

**Evan is paid annual bonus on March 31st of each year.**

**The amount of the March bonus should be divided by 12 to obtain an accurate calculation of the current monthly bonus amount.**



A common mistake is to average the prior year's gross income with the current YTD and divide by 15.

# Variable Income Calculations

**If a borrower is paid overtime on a bi-weekly basis, the most recent paystub must be analyzed to determine that both the current overtime earnings for the period and the year-to-date overtime earnings are consistent and, if not, why**

- There are legitimate reasons why these amounts may be inconsistent yet still eligible to use as qualifying income.
  - ✓ For example, a landscaping business that provides snowplowing services in the winter may not show consistent overtime.
- Always investigate the difference between current period overtime and year-to-date earnings and document the analysis before using the income amount in the trending analysis.



# 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 multiple businesses listed on Schedule E, K1s must be provided, if they own 25% or more of that business, full returns are required.
- For applications made **prior to August 11, 2021**, documentation must be no older than 60 days on the date the Note is signed.



## Additional Oversights (continued)

- Schedule C income increased in 2020 from 2019. Only 2020 income was used for qualifying when a 24-month average should have been used.
- A 24-month average was used when income declined in 2020 from 2019. Only the 2020 income should have been used.
- 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





# Credit Reports

**What's the current maximum age of a credit report?**

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

We are now back to credit reports being no older than 120 days on the day the Note is signed.

With that longer period of time, how confident are you that a borrower's credit history didn't change between the credit report date and closing?

*Remember for loans closed before August 11, 2021 the maximum age is still 60 days.*



# 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”.

### Perform a *soft pull* of credit report before closing

- A soft pull 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 DU or LPA, the applicable tolerances for resubmission must be followed.



# 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

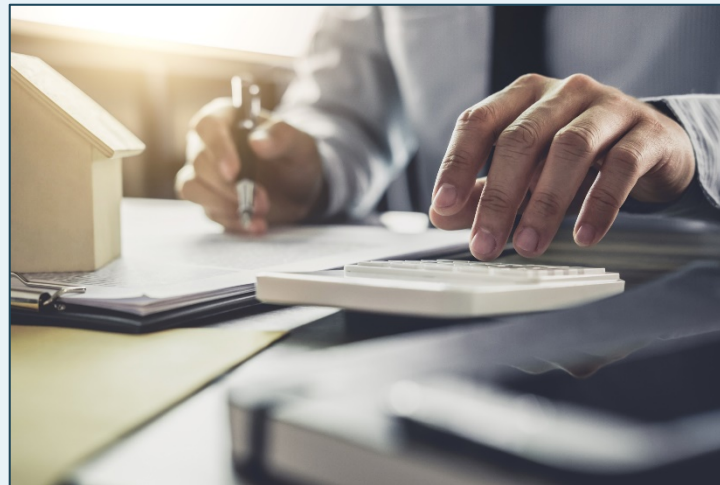
**1** Description: The borrower's credit was not sufficiently documented. A monthly installment payment in the amount of \$497 was omitted from the borrower's DTI ratio; however, no documentation was provided to support this exclusion. Please refer to DU condition 9. Type: Documentation

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



# Obligations Related to Real Estate

- We are often missing documentation that breaks out the amount of taxes and insurance that's been included in the DTI.
- We also need evidence when taxes and insurance are escrowed and part of the total mortgage payment.



# Assets



# Unsourced Assets

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

Large deposits shown bank statements or funds to open a new account need to be properly sourced.

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.

# 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.

Account Summary for Statement Savings -										
Starting Balance	+	Deposits	+	Interest Paid	-	Withdrawals	-	Service Charges	=	Ending Balance
0.00		13,000.00		0.00		0.00		0.00		13,000.00

Transactions for Statement Savings -				
Date	Description	Checks/ Debits	Deposits/ Credits	Balance
02-04	Starting Balance			0.00
02-04	New Account Deposit		13,000.00	13,000.00

The amount of Interest earned between 02-04-2021 and 02-24-2021 is \$1.12.  
The average daily balance during this period was 13,000.00.  
The minimum balance during this period was 13,000.00.  
The Annual Percentage Yield Earned for this account is 0.15%.

# Miscellaneous



# 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?





# 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.



# Loan Delivery

**We have seen a wave of loans that were funded into the program prior to the loan closing at the title company**

There have been 14 loans that have delivered in the last 9 months. These are repurchases for the MPF Xtra product.

A loan cannot be re-sold back into the MPF Program once it closes.



# Best Practices

- Perform the verbal verification of employment as close to the closing date as possible.
- Fully investigate all credit inquiries made in the past 90 days. A soft pull of the borrower's credit just before closing may help determine if new credit was established, or if there were major changes since the initial credit report.
- Limit items to be collected at closing. The more loose ends the more likely a mistake can be made.
- Use income calculation worksheets (show your work!)
- Have a process in place to ensure everything in the loan file has been validated.

# Best Practices

- 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!
- Reach out to either your local FHLB, the MPF Service Center or the MPF QC team if you are ever uncertain about a loan. It's best to ask before delivering that could be ineligible.



# 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) 345-2673

## MPF Quality Control

[mpfinvestordirectqc.fhlbc.com](http://mpfinvestordirectqc.fhlbc.com)



# MPF National Education



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