

**MPF Program Quality Control**

# **Top Ten Common Findings and How to Avoid Them**

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## Where did we get this information?

- Fannie Mae's *Quality Insider* publication
- MPF Program Quality Control statistics



# #1 Incorrect Monthly Obligations



**The credit report shows an account with a balance, but there is no payment provided**

- Account was ignored with no payment held against the borrower
- A payment was calculated, but incorrectly

**Which account type payment is most likely to be calculated incorrectly?**

**Student Loans**

# How to Avoid Issues with Student Loan Payments

If a borrower has multiple student loans in deferment or forbearance, should the payments be calculated separately or combined?

**The unpaid balances can be combined**

- Payments for deferred loans or loans in forbearance cannot be excluded from the borrower's obligations
- If no payment is reflected on the credit report, 1% of the loan balance can be used (loans underwritten with DU<sup>®</sup> and manually underwritten MPF<sup>®</sup> Traditional and MPF Xtra<sup>®</sup> loans)
- MPF Traditional loans underwritten with LPA<sup>SM</sup> use 0.5% (see Freddie Mac Selling Guide for specific guidance)
- The borrower may also provide evidence of the actual loan terms and/or payment(s)



# #2

## Undisclosed Liabilities and Mortgages



**While incidents of undisclosed debt have been decreasing, it is still in the top 10!**

- Undisclosed debt is any debt that is established during the *quiet period* of the loan origination process
- The *quiet period* is the time between the first credit pull and closing
- Many borrowers are unaware of the implications of establishing new debt prior to closing

## How to prevent and identify undisclosed debts



- Educate borrowers and ask about new debt at each touchpoint
- Look for automatic withdrawals on asset statements
- Include a *soft pull* credit check prior to closing
- Have the borrower sign a *no new debt* disclosure at closing
- Target loans in pre-closing QC reviews with higher debt-to-income ratios
- Consider using an undisclosed debt monitoring (UDM) service

## Equifax has some interesting statistics about undisclosed debt



What percentage of borrowers open a new tradeline during the quiet period?

36%

What percentage of borrowers apply for an auto loan during the quiet period?

5%

*Did you know that 23% of fraudulent mortgage applications contain misrepresented liabilities?*



## What's the difference between a UDM and a soft credit pull?

**A soft credit pull (aka soft inquiry) is a credit check that doesn't affect the borrower's credit score**

- Initiated by the lender at a set point prior to closing

**UDM is a credit monitoring service that sends alerts when activity on a borrower's credit is detected**

- Generally active over the quiet period, can be turned on and off



# #3

## Variable Income



## Calculating variable income continues to be a challenge

- Two or more years of a particular type of variable income is recommended
- With positive factors, 12-24 months may be acceptable
- A trending analysis should be performed to determine the if the income is stable and consistent

# #3

## Variable Income



### What are the common missteps?

- Averaging/using variable income received from a previous employer
- Averaging declining income
- If the variable income shows a decline, there is no documentation in the file to evidence the income has since stabilized
- Using variable income from a new job without evidence of receiving similar income from a previous employer(s)

***Remember, variable income types and borrower situations vary, so sometimes they need to be considered on a case-by-case basis***



# Variable Income



You have Clair's YTD paystub through August 31. She received a bonus on July 1 and has received a bonus every July 1 for the past 3 years. How would you calculate the bonus income?

- a. Divide the bonus by 8
- b. Divide the bonus by 12
- c. Average the bonus with last year's bonus and divide by 18
- d. Average the bonus with last year's bonus and divide by 24
- e. Other

**e. Other! We need to determine how the bonus has been trending before knowing if it can be averaged!**

# #4

## Rental Income and Occupancy



Most defects were a result of using rental income from a departing residence

- Rental income was not calculated correctly
- In some cases, it was determined that the property wasn't being rented!

# Rental Income Documentation for a departure residence



Documentation must be obtained to confirm the property lease is in effect

- Signed lease(s)
- Two months consecutive bank statements or electronic transfers evidencing receipt of payments **or**
- Copies of the security deposit and first month's rent check with proof of deposit (for new leases)



# Rental Income/Loss



The PITIA for the departure residence must be subtracted from 75% of the documented monthly rental income

How would you treat the result?

If the result is a negative number:

- Include the amount in the borrower's monthly liabilities

If the result is a positive number:

- **Do nothing with the positive amount.** You may only offset the PITIA for a departure residence being converted to a rental property

# Is the departure residence really rented out?



## How to confirm that a departure property is rented

- Collect the required lease(s), rental payment(s) and/or security deposit documentation
- Leverage data and perform due diligence during origination and in QC

# #5

## Self-Employed Borrower Documentation



**When using DU or LPA, defects resulted from using only one year of tax returns to calculate income when the findings/guidelines require two years**

- Always consider self-employed income from the required timeframe
- Utilize income worksheets or Fannie Mae's Income Calculator



**Be aware of the  
requirements for  
using one year of  
individual federal  
tax returns for self-  
employed  
borrowers**

**To Use One Year of Individual Federal Tax Returns**

- The business (or businesses) must be in existence for at least 5 years
- The borrower must have had a 25% or more ownership in the business (businesses) consecutively for at least 5 years
- Documentation to evidence ownership may include an IRS-Issued Employer Identification Number Confirmation letter, business license, articles of incorporation, or partnership agreements

**Be aware of the requirements for using one year of business tax returns for self-employed borrowers**

**To Use One Year of Business Returns**

- The borrower must provide two years' worth of signed individual federal tax returns
- The borrower must have had a 25% or more ownership in the business (businesses) consecutively for at least 5 years
- The borrower must be using personal funds for all down payment and closing costs and satisfy the reserve requirements
- The individual tax returns must show an increase in the self-employment income over the past two years

## #6 Borrower Employment



**The borrower was not  
employed at the time of  
closing**

Most lenders perform a verbal  
verification of employment  
just prior to closing



# Borrower Employment



Additional due diligence can help to  
confirm a borrower's employment status  
at the time of closing

Signed borrower  
attestation

Email the borrower at their  
work email address

Internet searches

Call the borrower's employer  
on the day of closing

#7

## Misrepresenting Occupancy



### Misrepresenting the use of a property is considered occupancy fraud

- Desire for a lower interest rate
- Don't have the required down payment for an investment property
- May purchase as an investment property\* but live in it as a primary residence because they need rental income to qualify (reverse occupancy fraud)

\*Investment properties are only eligible under the MPF Xtra product

# Occupancy Red Flags



- Unrealistic commute from the subject property to the borrower's place of employment (not a work from home situation)
- Homeowners insurance is a rental policy or does not include personal property or contents coverage
- The property and mailing address are different on the homeowner's insurance policy
- Sales contract is subject to an existing lease
- Second homes that don't make sense as a second home (too close in proximity to the borrower's primary residence or not in vacation or recreational area)
- Downsizing or purchasing a property that doesn't seem to match the borrower's current situation (i.e., purchasing a 1-bedroom condo with a family of six)

# #8

## Missing Gift Documentation

**Many borrowers utilize gift funds for all or a portion of their down payment and closing costs**

**Gift letter from the donor must include:**

- The actual or maximum amount of the gift
- A statement that no repayment is expected
- The donor's name, address, phone number, and relationship to the borrower

**Evidence of receipt can be in the form of:**

- Copy of the donor's check, and the borrower's deposit slip
- Copy of the donor's withdrawal slip and the borrower's deposit slip
- Evidence of electronic transfer of funds from the donor's account to the borrower's account or closing agent
- Copy of the donor's check to the closing agent or settlement statement showing receipt of the donor's check





# Acceptable Gift Donors



## Relatives

- Borrower's spouse
- Parent or child
- Other dependent
- Any other individual related by blood, marriage, adoption or legal guardianship

## Non-relatives

- Someone who shares a familial relationship with the borrower defined as a domestic partner or relative of domestic partner
- An individual engaged to marry the borrower
- Former relative
- Godparent

***The donor should not be or be affiliated with the builder, developer, real estate agent or any other interested party to the transaction***

## #9 Evidence of Completion

Watch out for as-is  
appraisals!

Review the appraisal  
photos for any evidence  
of obvious condition  
issues or incomplete  
construction/repairs

### *Subject to* appraisals required evidence of completion

**When completion of repairs or new construction are required prior to loan delivery, evidence of completion must be provided**

- Many files are missing an *Appraisal Update* (FNMA 1004D) or *Completion Report* (FHLMC 442)
- An alternative method to confirm completion may also be acceptable for loans underwritten using DU or LPA

# ***Subject to appraisal alternative documentation options***

## **In some cases, alternatives to the 1004D may be acceptable (DU or LPA only)**

- 1004D/442 with a virtual inspection, digital photos, or site videos instead of an on-site visual inspection
- All completion documentation must include one or more visually verifiable exhibits
- A borrower/builder attestation letter may be acceptable in lieu of a 1004D/442 for new construction (subject to minimum requirements)
- A borrower attestation letter may be acceptable to confirm certain repairs (subject to minimum requirements)

# #10 Incomplete or Incorrect 1003

*Usually not cited but  
does result in a QC  
exception*

The loan application should be completed correctly  
Here's a common example from a purchase  
transaction:

<b>Current Address</b>					
Street	300 West Anystreet				Unit #
City	Princeville		State	CO	ZIP 00000 Country
How Long at Current Address?			8	Years	Months
Housing			<input type="radio"/> No primary housing expense <input checked="" type="radio"/> Own <input type="radio"/> Rent (\$ /month)		

Section 3 is  
missing the  
departure  
residence  
information!

<b>Section 3: Financial Information — Real Estate.</b> This section asks you to list all properties you currently own and what you owe on them. <input type="checkbox"/> I do not own any real estate					
<b>3a. Property You Own</b> If you are refinancing, list the property you are refinancing FIRST.					
Address		Street		Unit #	
City		State		ZIP Country	
Property Value	Status: Sold, Pending Sale, or Retained	Intended Occupancy: Investment, Primary Residence, Second Home, Other	Monthly Insurance, Taxes, Association, etc. if not included in Monthly Mortgage Payment	For 2-4 Unit Primary or Investment Property	
				Monthly Rental Income	For LENDER to calculate: Net Monthly Rental Income
\$			\$	\$	\$
Mortgage Loans on this Property <input type="checkbox"/> Does not apply					
Creditor Name	Account Number	Monthly Mortgage Payment	Unpaid Balance	To be paid off at or before closing	Type: FHA, VA, Conventional, USDA-RD, Other Credit Limit (if applicable)
		\$	\$	<input type="checkbox"/>	\$
		\$	\$	<input type="checkbox"/>	\$



# #10

## Incomplete or Incorrect 1003

*Usually not cited but  
does result in a QC  
exception*

The loan application should be completed correctly

### Another example:

- The employment information on the 1003 does not match the W2s in the file
- Not all employment is listed on the 1003 or, employment is listed without the associated W2

# Best Practices



- **Employ additional due diligence for files with higher DTI ratios to identify items that could make the loan ineligible:**
  - undisclosed liabilities
  - income calculation errors
- **Watch for recent changes in:**
  - employment
  - position
  - compensation
  - pay structure
- **Have strong pre- and post-closing QC procedures in place to prevent findings and potential repurchases**

# MPF Contacts and Resources

## MPF Service Center

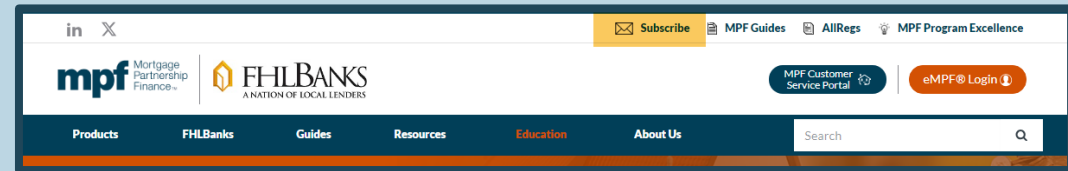
Email - [MPF-Help@FHLBC.com](mailto:MPF-Help@FHLBC.com)

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

Phone: (877) 345-2673

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