PennyMac Correspondent Group

Announcement 16-05

Date: February 1, 2016

Topic: Fannie Mae SEL 2014-16 and 2015-09: Self-Employed Income Calculation

Effective with applications taken on or after February 1, 2016, for all DU approved conventional loans, PennyMac is aligning with Fannie Mae's updated self-employment income policies relating to 1065 partnerships and 1120-S corps.

Per Fannie Mae B3-3.2.2:

> Business income may only be used to qualify the borrower if the lender obtains documentation verifying that
>
> - the borrower has ownership of the income (Schedule K-1 may be used to document ownership share), and
> - the income was actually distributed to the borrower.
>
> Alternatively, the lender can obtain documentation verifying that
>
> - the borrower has access to the income through a corporate resolution or other documentation that the lender determines is appropriate—unless the borrower(s) own 100% of the business, in which case confirmation of access to the income is not required; and
> - the business has adequate liquidity to support the withdrawal of earnings.

Business income* should be calculated based on the number of years of tax returns required by DU:

- If DU requires one year of tax returns, the lesser of business income or distributions should be used for qualifying income.
- If DU requires two years, and the business income is decreasing, then the qualifying income should be the lesser of the current year business income or current year distributions.
- If DU requires two years, and the business income is the same or increasing, then
  - A) Calculate the business income based on the most recent 24 months,
  - B) Average the distributions over the same 24 months,
    - If the current year distributions are $0, the borrower will need to demonstrate access to the income and business liquidity.

- The qualifying income should be the lesser of A or B.

*Business income includes all adjustments that would normally be required to calculate self-employed income. Distributions are the amount of money the borrower actually received from the business, as documented on the K-1.

Examples: Green indicates amount that should be used to qualify. All examples assume two years tax returns are required.

	2013	2014	Income Used to Qualify
Income	$20,000	$15,000	$15,000/12 = $1,250
Distribution	$10,000	$5,000	$5,000/12 = $416
Income	$20,000	$15,000	$15,000/12 = $1250
Distribution	$5,000	$10,000	$10,000/12 = $833
Income	$15,000	$20,000	$35,000/24 = $1,458
Distribution	$10,000	$5,000	$15,000/24 = $625
Income	$15,000	$20,000	$35,000/24 = $1,458
Distribution	$17,000	$23,000	$40,000/24 = $1,666
Income	$15,000	$20,000	$35,000/24 = $1,458
Distribution	0	0	$0/24 = $0
Income	$15,000	$20,000	$35,000/24 = $1,458
Distribution	0	$10,000	$10,000/24 = $416
Income	$15,000	$20,000	$35,000/24 = $1,458
Distribution	$25,000	0	$0/24 = $0

If distributions are insufficient to support the business income, the following alternative approach may be used:

The business income may be used to qualify if both “1” and “2” are met:

1. Document the borrower’s access to the business funds via:
   - 100% ownership,
   - A partnership agreement indicating access,
   - A corporate resolution indicating access, or
   - Other documentation determined to be appropriate.
2. The business has adequate liquidity to support the withdrawal.
   - Liquidity is defined as documented liquid business assets less business liabilities.

Please contact your Sales Representative with any questions.