



Due to the impact of COVID-19, Fannie Mae and Freddie Mac have announced temporary guidance and additional documentation requirements for Self-Employed borrowers. Those additional documentation requirements and analysis guidelines are indicated below, as stated in Fannie Mae Lender Letter (LL-2020-03) and Freddie Mac Bulletin (2020-19). These requirements are effective June 11, 2020 and until further notice.

Minimum Additional Documentation Requirements

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Either:

- An **unaudited** year-to-date profit and loss statement signed by the borrower reporting business revenue, expenses and net income up to and including the most recent month preceding the loan application date and three* business depository account(s) statements no older than the latest three months represented on the year-to-date profit and loss statement.
 - *For example, the business depository account statements can be no older than August, September, October for a year-to-date profit and loss statement dated through October 31st.*
 - *The lender must review the three months recent depository account statements to support and/or not conflict with the information presented in the current year-to-date profit and loss statement. Otherwise, the lender must obtain additional statements or other documentation to support the information from the current year-to-date profit and loss statement.*

OR

- An **audited** year-to-date profit and loss statement reporting business revenue, expenses and net income up to and including the most recent month preceding the loan application date.

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Either:

- An **unaudited** year-to-date (YTD) profit and loss statement that is signed by the Borrower and reports business revenue (i.e. gross receipts or sales), expenses and net income. The information in the YTD profit and loss statement must cover the most recent month preceding the Application Received Date and be dated no more than 60 calendar days prior to the Note Date.

AND

- Three* months business account statements no older than the latest three months presented on the YTD profit and loss statement.
 - *For example, if the YTD profit and loss statement is through September 30, 2020, the business account statements can be no older than for July through September*
 - *Personal asset account statements evidencing business deposits and expenses may be used when the Borrower is an owner of a small business and does not have a separate business bank account*

OR

- An **audited** YTD profit and loss statement reporting business revenue (i.e. gross receipts or sales), expenses and net income. The information in the YTD profit and loss statement must cover the most recent month preceding the Application Received Date and be dated no more than 60 days prior to the Note Date.

Reviewing the Documentation and Establishing Stable Monthly Income and Assessing the Impact of COVID-19

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Business Income

The lender must complete a business income assessment by comparing the year-to-date net business income from the year-to-date profit and loss statement to historical business income calculated using the Cash Flow Analysis (Form 1084 or any other type of cash flow analysis form that applies the same principles) for a similar timeframe (such as monthly).

- Lenders can make standard adjustments to business cash flow (net income on the profit and loss statement) in accordance with [B3-3.04](#), Analyzing Profit and Loss Statements when making this determination.
- When the lender determines net business income is impacted, but profit and loss details are not sufficient to determine the income is stable at the reduced level, the lender can obtain additional documentation to supplement the profit and loss statement (such as a month-to-month income trending analysis) to make this determination. If stability cannot be confirmed, the income is not eligible for qualifying purposes. See [B3-3.1-01](#), General Income Information for details.

Example

Historical monthly self-employment income calculated using Form 1084 = \$2,000.

Current level of stable monthly self-employment income as determined by the lender using details from the year-to-date profit and loss statement and other supplemental documentation = \$1,000.

The impact of the COVID-19 pandemic on current business income results in a 50% decline from historical levels. See [Business Income Calculation Adjustment](#) below for next steps.

**effective December 14,2020, change from two to three months*

Business Income Calculation Adjustment

When the lender determines current year net business income has been impacted by the COVID-19 pandemic and is:

- Less than the historical monthly income using Form 1084, but is stable at its current level, the lender must reduce the amount of qualifying income calculated using form 1084 to no more than the current level of stable income as determined by the lender (see [Business Income](#) above).
- More than the historical income calculated using Form 1084, the lender must use no more than the currently stable level of income calculated using Form 1084 to qualify the borrower.

In all cases, qualifying income must be supported by documentation, including any supplemental documentation obtained by the lender.

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- The Seller must determine if the business revenue documented in the unaudited YTD profit and loss statement are reasonably consistent with the revenue documented on the business bank statements.
- If the information on the YTD profit and loss statement is not reasonably consistent with the information of the business account statements, additional documentation (e.g. month-to-month or quarterly trending for YTD profit and loss, additional months and/or more recent bank statements) must be obtained to support the information and resolve the discrepancy.
- If the unaudited YTD profit and loss statement cannot be supported by business account statements and/or other documentation, the self-employment income is not eligible for use in qualifying.
- If the unaudited YTD profit and loss statement is supported, or if an audited YTD profit and loss statement is used, proceed to determining the current level of stable monthly income as outlined below.

Establishing stable monthly income

- The Seller must review the YTD profit and loss statement (unaudited or audited), business account statements and all other relevant factors and documentation to determine the extent to which a business has been impacted by COVID-19. Refer to Business review and analysis section below for additional information regarding relevant factors.
- The Seller must establish the current level of stable monthly self-employment income using details from the YTD profit and loss statement, business account statements, and supplemental documentation as applicable.
- The Seller must determine whether the income level has declined by comparing the information of the YTD profit and loss statement to the business revenue (i.e. gross receipts or sales) and expenses reported on the most recent year's business tax return(s), and net monthly income as calculated in accordance with requirements and guidance in [Chapter 5304](#), including use of Guide Form 91, Income Calculations, or a similar alternative form.

The income level has not changed or has increased.

Use the qualifying income calculated following standard requirements and guidance in [Chapter 5304](#), including the use of Form 91 or a similar alternative form. A YTD profit and loss statement, audited or unaudited, cannot be used to support a higher level of income than the amount derived from Form 91 or a similar alternative form.

The income level has declined.

- Determine if the income has stabilized. The Seller may need to obtain additional documentation to supplement the YTD profit and loss statement (e.g., a month-to-month income trending analysis, additional months and/or more recent business account statements) to make the determination.
- If the income has stabilized:
 - *Use no more than the current level of stable monthly self-employment income using details from the YTD profit and loss statement, business account statements, and supplementation documentation, as applicable.*
 - *Adjustments (e.g., depreciation) to the YTD profit and loss net income may be made in accordance with the requirements and guidance in [Guide Section 5304.1\(d\)](#) and Form 91, and in alignment with the adjustments based on the tax returns, as appropriate.*
- If the income is declining and has not stabilized, then the income is not eligible for qualifying.

Impact on Business

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Business Stability

- Does the profit and loss identify a significant imbalance between expenses and revenue that may impact financial stability? Or have modifications to current business operations been made to correct this imbalance? (Consider documenting with an updated business plan).
- Do prior year business tax returns demonstrate ample financial liquidity due to a history of retained earnings?
- Do current business account balances (excluding Paycheck Protection Program (PPP) or other similar COVID-19 related loan or grants) support the financial ability of the business to operate given current market and economic conditions?

A current balance sheet may be used to support the lender's determination of business stability, in conjunction with the profit and loss statement.

Business Operations

- Have business operations been maintained or modified to support continued business income?

For example, review an updated business plan.

- Is the business continuing to operate in the current location or an alternate location suitable for business operations?

For example, perform an Internet search or verify through a third-party source.

- Is there a demand for the product or service currently offered by the business?

For example, obtain current business receipts or purchase contracts.

- Is the business operation and/or revenue temporarily restricted due to state shelter in place, stay at home or other similar state or local orders?

- Is the impact to the business operations negligible due to the nature of the business?

For example, obtain a written explanation from the business owner or confirmation that income is seasonal apart from the event timeline.

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Business review and analysis

The Seller continues to be responsible for establishing that the Borrower's income is stable and likely to continue at the same level as used to qualify the Borrower. It is also expected that all Sellers ensure they are knowledgeable of the economic conditions related to a Borrower's business. The documentation and the Seller's analysis of the business must support that the business has sufficient liquidity and is financially capable of producing stable monthly income for the Borrower. In addition to the business review and analysis requirements and guidance in [Section 5304.1\(d\)](#), the Seller must consider pandemic-related factors which may include but are not limited to, the following:

- If the ability of the business to generate revenue or operate at full capacity has been negatively impacted by the pandemic, have business operations been modified to support continued revenue? Is continued business revenue supported by any other documentation or information supplied by the Borrower (e.g., modified business plans) or obtained from other sources?
- Impacts to the business operation, revenue and/or expenses, such as a break-down in the supply chain that is needed to maintain the product, a higher cost of expenses to obtain the product, or a lack of consumer demand for the product or service.
- Impacts to the business operation, revenue and/or expenses due to temporary restrictions such as State shelter-in-place, stay at home or other similar State or local orders.
- If temporary restrictions have been recently lifted, will the business continue to operate at a reduced level of revenue and/or increased level of expenses for a long enough period to establish income stability and is this documented with more recent business bank account statements evidencing this revenue flow or other equivalent information?
- Does the business currently have documented liquid assets or access to capital for operating expenses that support the financial ability of the business to operation given current market and economic conditions? Are those assets comprised of or supplemented by loan proceeds from the Small Business Administration (SBA) Payroll Protection Plan (PPP) or any other similar COVID-19-related program (e.g., federal, State or local level business loans and grants)? A current balance sheet may be used to support the lender's determination of business stability, in conjunction with profit and loss statement and business bank statements.
- Additional economic information related to the business such as:
 - *Whether the business is part of an industry that is experiencing increasing negative pandemic-related impacts.*
 - *Reputable news sources and economic forecasts related to the business industry and pandemic progression.*
 - *Whether the business type is in what is considered a high contact-intensive industry and if the higher risk of exposure to COVID-19 may present an impact to the potential for income stability and/or continuance until the medical issues surrounding the pandemic are closer to being resolved, whether or not there are State or local orders that temporarily restrict the business operation.*

Business Assets

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We are clarifying that proceeds from the Small Business Administration PPP or any other similar COVID-19 related loans or grants are not considered business assets. Refer to [B3-4.2-02](#), Depository Accounts for details.

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Loan proceeds from the SBA Payroll Protection Plan (PPP) and/or any other similar COVID-19-related program(s) (e.g., federal, State or local level business loans and grants) are not considered business assets (as described in [Section 5501.3\(b\)\(iv\)](#)) for the purpose of eligible funds to qualify the Borrower for the Mortgage transaction, including, but not limited to funds for Down Payment, Closing Costs and reserves.