



CONVERTING A PRIMARY RESIDENCE TO RENTAL INCOME

FHA

Overview

When a primary residence is being converted into a rental property, always determine if the borrower has a history of property management experience.

Documentation Required

The following documents are required for calculation of rent income:

- Lease Agreement
- Proof of receipt of security deposit and first month's rent
- Appraisal of converting property for proof of 25% equity
- Confirmation that the property being converted and the subject property have at least 100 miles between one another.

Calculation Method

75% Rule

Following the criteria below, the lesser of 75% of the lease agreement amount, 1007, or 1025 must be used to determine the net rental income.

Rental Income/Property Management experience ≥ 1 Year

- Calculate the net rental income by averaging the amount shown on Schedule E.
 - o Positive net rental income can be added to the borrower's effective income.
 - o Negative net rental income must be included as a debt/liability.

Rental Income/Property Management experience < 1 Year

• Annualize rental income for the length of time the property has been owned and document the date of acquisition.

No history

• Deduct PITI from 75% of the lesser of fair market rent reported by appraiser or the rent reflected in the lease agreement.



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UNIONHOME MORTGAGE

Scenario

In this scenario, the borrower is converting a primary residence to a rental property and has less than a year of property management experience.

- The lease agreement confirms that the term is at least one full year.
- Rent is \$2500.00 per month as shown in the lease agreeement.
- The mortgage statement confirms that taxes and insurance are escrowed.
- The property has HOA dues of \$700 per year (\$58.33/mo).
- The mortgage balance is \$83,000.00.
- The appraisal value is \$290,000.00 (borrower meets 25% equity requirement).
- Form 1007/1000 Comparable Rent Schedule monthly market rent amount is \$1750.
- The relocation requirement is met (primary residence in GA and new purchase is in TX which is 100+ miles distance).

Rental Income Method

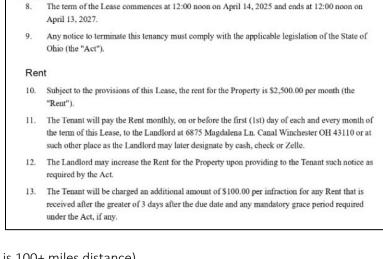
- The borrower has rental income/property management experience of less than one year.
 - Rental income can only be used to offset PITIA (i.e., it is limited to zero positive cash flow).
- Full PITIA is \$806.25.
- To determine the Gross Rental Income amount, divide the full PITIA by 0.75.
 - 806.26/0.75 = \$1075.00

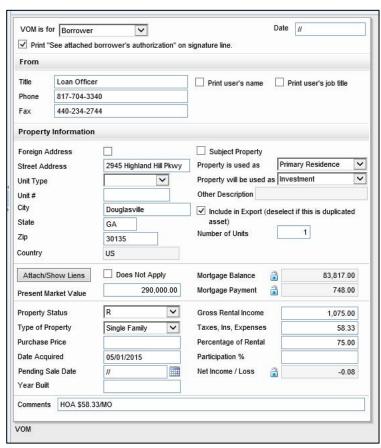
Encompass Summary

- Percentage of Rental field = 75.00
- Gross Rental Income field = \$1075.00
- Taxes, Ins, Expenses field= \$58.33 for HOA dues

Result

The borrower meets all FHA guidelines to offset rental income for converting their primary residence to an investment property.









Important Notes

75% Rule

• When the property has been owned for a year or more, the lease agreement and 75% factor can only be used in extenuating circumstances in which the credit underwriter deems acceptable.

Exception of adding back in repairs

- Need copies of all invoices and paid receipts that detail what each repair item was.
- Documentation must be reviewed by a credit underwriter to determine what can be added back in.
- Typical wear and tear of a property (cosmetic) is not considered an extraordinary, one-time expense/repair.

Taxes, Ins, Expenses field in Encompass

• This field is used for tax, insurance, and HOA dues, but for rental income scenarios, it is also used as total expenses after addbacks from schedule E.