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Employment Related Income

Stability of Income

Effective Income

Income may not be used in calculating the consumer's debt-to-income ratio if it comes from any source that cannot be verified, is not stable, or will not continue.

Verifying Employment History

The creditor must verify the consumer's employment for the most recent two full years, and the creditor must require the consumer to:

- Explain any gaps in employment that span one or more months, and
- Indicate if he/she was in school or the military for the recent two full years, providing evidence supporting this claim, such as college transcripts, or discharge papers
- Allowances can be made for seasonal employment, typical for the building trades and agriculture, if documented by the creditor.
- A consumer with a 25 percent or greater ownership interest in a business is considered self- employed and will be evaluated as a self-employed consumer

Analyzing a Consumer's Employment Record

When analyzing a consumer's employment, creditors must examine:

- The consumer's past employment record; and
- The employer's confirmation of current, ongoing employment status
- Creditors may assume that employment is ongoing if a consumer's employer verifies current employment and does not indicate that employment has been, or will be terminated. Creditors should not rely upon a verification of current employment that includes an affirmative statement that the employment is likely to cease, such as a statement that indicates the employee has given (or been given) notice of employment suspension or termination
- Creditors may favorably consider the stability of a consumer's income if he/she changes jobs frequently within the same line of work, but continues to advance in income or benefits. In this analysis, income stability takes precedence over job stability

Extended Absence

When a borrower is returning to work after an extended absence:

- Income may be considered effective and stable when recently returning to work after an extended absence if he/she is employed in the current job for six months or longer; AND can document a two year work history prior to an absence from employment. The following documentation is required:

    - Traditional employment verifications; and/or
    - Copies of IRS Form W-2s or pay stubs
- An acceptable employment situation includes individuals who took several years off from employment to raise children, then returned to the workforce
- Extended absence is defined as six months

NOTE: *Situations not meeting the criteria listed above may not be used in qualifying*

Salary, Wage and Other Forms of Income

Consumer Income Analysis

The income of each consumer who is obligated for the mortgage and whose income is being used to determine ability to repay must be analyzed to determine if the income level can be reasonably expected to continue

NOTES:

I. *Income for consumers planning to retire during the first three-year period of the mortgage term must include:*
    - *Documented retirement benefits*
    - *Social Security income OR*
    - *Other payments expected*

II. *Creditors may not ask the consumer about possible, future maternity leave*

III. *Creditors may assume that salary or wage income from employment verified above can be reasonably expected to continue if the employer does not indicate that employment has been or is about to terminate*

Overtime and Bonus Income

Overtime and bonus income can be used to qualify if the income has been received for the past two years and there is documentation that this income will not cease

An average of the past two year overtime and/or bonus income is used to qualify, periods of overtime and/or bonus less than two years may be acceptable providing that there is a written and documented reason for using the income

Overtime and Bonus Income Earning Trend

Establish and document an earnings trend, if overtime and/or bonus show a decline then the file must include a written sound rationalization for including the declining income

A period of more than two years must be used to calculate overtime and/or bonus if there is significant variation from year to year

Part Time Income
Part time income may be used if there is documentation that the consumer has worked the part time job **uninterrupted** for the past two years and plans to continue
Many low and moderate-income families rely on part time income and the creditor must not restrict consideration of such income

Part time income received for less than two years may be included as effective income provided that there is a written justification and documentation for using this income

Seasonal Income
Seasonal income is considered uninterrupted and may be used to qualify if the following is documented:
- Consumer has worked at the same job for past two years AND
- Expects to be rehired the next season

Primary Employment Less than 40 Hour Work Week
If primary employment is less than a typical 40 hour work week, the stability of the income as regular and on-going must be evaluated and documented

Commission Income
Commission must be averaged over the past two years and the following documentation is required:
- Signed tax returns for the past two years AND
- Most recent paystub

If commission income was received for more than one year but less than two years that income may be considered with the following:
- Document the likelihood that the income will continue AND
- Rationalize accepting the commission income

Commission income earned for less than one year is not considered effective income, however an exception may be made when salary/wages have changed to commission income for the same position with the same employer

NOTES:
I. *Unreimbursed business expenses must be subtracted from gross income*
II. *A commissioned consumer is one who receives more than 25% of his/her annual income from commissions*
III. *Tax transcripts obtained directly from the IRS may be used in lieu of signed tax return*

Employer Differential Payments
If an employer subsidizes a consumer's mortgage payment through direct payments the amount of the payments is:
- Considered gross income AND

- Cannot be used to offset the mortgage payment directly, even if the employer pays the mortgage directly

Retirement Income

Retirement income must be verified with the former employer or from Federal tax returns

If any retirement income is expected to cease within the first full three years of the mortgage it may not be used to qualify

Social Security Income

Social Security income must be documented with a Social Security Administration award/benefit letter

Should benefits expire within the first full three years of the mortgage the income may not be used to qualify

If the award/benefit letter does indicate a defined expiration date within three years of loan origination the income may be used to qualify

Pending or current re-evaluation of medical eligibility for benefit payments is not considered an indication that the benefits are not likely to continue

If the Social Security benefit is considered non-taxable the income may be "grossed-up"

Auto Allowance and Expense Account Payments

May only consider the amounts that exceed the consumer's actual expenditures

When considering this income the following is required:

- IRS Form 2106 for the past two years AND
- Employer verification that the payments will continue

If the standard per-mile rate is used as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income:

Expenses that must be treated as recurring debt include:

- The consumer's monthly auto payment
- Any loss from the calculation of the difference between the actual expenditures and the expense account allowances

Consumer Employed by a Family Owned Business

In addition to regular employment verification, a consumer employed by a family business is required to provide evidence that he/she is not an owner of the business, documentation may include:

- Copies of signed personal tax returns OR

- A signed copy of the business tax return showing ownership percentage

Self Employed Consumers and income Analysis

Definition

A consumer with a 25% or greater ownership interest in a business is considered self-employed

Minimum Length of self employment

Income for self-employment is considered stable and effective if the consumer has been self-employed for two or more years

Due to the high probability of failure during the first few years of a business, the requirements described below are necessary for consumers who have been self-employed for less than two years:

If self employment period is:	Then:
Between one and two years	Must have at least two years of documented previous successful employment in the line of work in which the consumer is self-employed or in a related occupation A combination of one year of employment and formal education or training in the same line of work as the self-employment
Less than one year	Income is not allowed

Documentation Requirements for Self-Employed

The following documentation is required:

- Signed and dated individual tax returns with all applicable schedules for the most recent two years
- For a corporation, S corporation or partnership, signed Federal business tax returns for the past two years, with all applicable schedules AND
- Year to date profit & loss (P&L) and balance sheet

Self Employed Income Earnings Trend

It is required to establish earnings trend from the previous two years using tax returns
If the consumer:

- Provides quarterly tax returns, the income analysis may include income through the period covered by the tax filings OR
- Is not subject to quarterly tax returns, or does not file them, then the income on the P&L may be included in the analysis, provided that the income stream based on the P&L is consistent with the previous years' earnings

If the P&L shows income that is considerably greater than what is supported on the tax returns, then only income from the tax returns can be used in the analysis

If the earnings trend for the previous two years is downward and the most recent tax return or P&L is less than the prior year's tax return, then the most recent year's tax return must be used to qualify

Analyze the Business's Financial Strength

The financial strength of the business was be determined by examining annual earnings. Earnings that are stable or increasing are acceptable; a significant decline in earning is not acceptable

Income Analysis – Individual Tax Returns (1040)

IRS Form 1040	Description
Schedule C Business Income	Depreciation and depletion may be added back to AGI
Schedule E Rents, Royalties & Partnerships	Depreciation and depletion may be added back
Schedule D Capital Gain/Loss	Three years' tax returns are required to use capital gain income
Schedule E Interest & Dividends	Taxable/tax-exempt income may be added back to AGI if: Income has been received for past two years AND Is expected to continue If the interest bearing account will be used as a source of funds for subject transaction, the interest/dividend income must be adjusted
Schedule F Farm Income	Depreciation and depletion may be added back to AGI
IRA, Pension, Annuity, Social Security Benefit	The non-taxable portion of these items may be added back to the AGI if the income is expected to continue for the first three years of the mortgage
Form 2106 Employee Business Expense	Business expenses must be subtracted from AGI
Adjustments to Income	The following adjustments may be added back to AGI: IRA and keough retirement distributions Penalties on early withdrawal of savings Health insurance deductions AND Alimony payments

Income Analysis – Corporate Tax Returns (1120)

Obtain percentage of ownership, when ownership does not appear on the tax returns, the ownership information can be obtained from the corporation's account, along with evidence that the consumer has the right to any compensation

To determine the self-employed income from a corporation the adjusted business income must:

- Be determined AND
- Multiplied by the percentage of ownership

The table below shows the adjustments that must be made in order to determine AGI

Adjustment Item	Description of Adjustment
Depreciation & Depletion	Add the corporation's depreciation & depletion back to the after-tax income
Taxable Income	Taxable income is the corporation's net income before Federal taxes – reduce taxable income by tax liability
Fiscal Year v Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return
Cash Withdrawals	Withdrawal of cash from the corporation may have severe negative impact on the corporation's ability to continue operations

Income Analysis – S Corporate Tax Returns (1120S)

Income for owners of an S corporation comes from W2 income and is taxed at the individual rate

Form 1120S, Compensation of Officers line item is transferred to the consumer's 1040

S corporation depreciation and depletion may be added back to income in proportion to ownership percentage

Income must be reduced proportionately by the total obligations payable by the corporation in less than one year

Withdrawal of cash from the corporation may have severe negative impact on the S corporation's ability to continue operations

Income Analysis – Partnership Tax Returns (1065)

Each partner pays his/her proportionate share of the partnership's net income

Both general and limited partnerships report on Form 1065 and the partner's share of income is carried to the Schedule E of Form 1040

Depreciation and depletion can be added back to income in proportion to the amount of ownership

Income must be reduced proportionately by the total obligations payable by the partnership in less than one year
Withdrawal of cash from the corporation may have severe negative impact on the S corporation's ability to continue operations

Non-Employment Related Income

Alimony, Child Support and Maintenance Income

Alimony, child support and/or maintenance income can be considered effective, if the following three items below are provided:

1. Payments are likely to continue for the first three years of the mortgage AND
2. The following documentation is provided:
    a. Final divorce decree OR
    b. Legal separation agreement OR
    c. Court order OR
    d. Voluntary payment agreement
3. Acceptable verification that payments have been received during the last 12 months with:
    a. Cancelled checks OR
    b. Tax Returns OR
    c. Court Records

Investment and Trust Income

Analyzing Interest and Dividends

Interest and dividend income may be used as long as tax returns or account statements support a two-year history of receipt – Average the income over a two-year period

Subtract any amounts that will be used for the subject transaction before calculating the projected interest and dividend income

Trust Income

Trust income may be used if the constant payments will continue for at least the first three years of the mortgage as evidenced by the trust documentation

Required trust income documentation includes a copy of the complete Trust Agreement or other trustee statement confirming:

1. Amount of the trust AND
2. Distribution frequency AND
3. Duration of payments

Notes Receivable Income

The following documentation is required

- Copy of the note to establish the amount and length of payment
- Evidence that the payments have been consistently been received for the past 12 months

If the consumer is not the original payee on the note it is necessary to verify that the consumer has the right to enforce the note

Military, Government Agency and Assistance Program Income

Military Income
In addition to base pay, military personnel may also be eligible for:
- Variable housing allowance
- Clothing allowance
- Flight or Hazard pay
- Rations
- Proficiency pay

The additional types of pay may be used to qualify as long as the probability of such pay will continue and is verified in writing

NOTE: *The tax-exempt nature of the pay allowances should also be considered*

VA Benefits
Direct compensation for service related disabilities from the VA is acceptable

Education benefits used to offset education expenses are not eligible to be used as income

Government Assistance Programs
Income from government assistance programs is acceptable as long as there is documentation to verify that the benefit will continue for at least three years

Unemployment Income
Unemployment income must have a two-year history and there must be reasonable assurance that the income will continue (This may apply to seasonal employment)

Mortgage Credit Certificates (MCC)
If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as income

Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment

Homeownership Subsidies

A monthly subsidy may be considered income if it is received under the housing choice voucher home ownership option from a public housing agency (PHA)
If the subsidy is received directly the amount is treated as income. The amount may also be treated as nontaxable income and can be grossed up by 25%

The subsidy may be considered as an offset to the monthly mortgage payment as long as the subsidy is paid directly to the servicer (May not be paid directly to the consumer)

NOTE: *Assistance payments made directly to the consumer must be treated as income*

Rental Income

Analyzing the Stability of Rental Income

Document the stability of rental income with:

- A current lease OR
- An agreement to lease
- A rental history over the previous 24 months that is free of unexplained gaps greater than three months (acceptable gaps may include student, seasonal or military renter or a property rehab)

Rental Income for Consumer Occupied Property

Rent for tenant occupied units may be used:

- Must deduct vacancy and maintenance
- Rent may not be used to directly offset the mortgage

Income from Roommates or Boarders in an SFR

- Rental income may be used in an SFR occupied as the consumer's primary residence
- The rental income can only be used if it's reflected on the consumer's tax returns

Rental Income Verification

The following documentation is required:

- IRS 1040 Schedule E AND
- Current lease/rental agreement

Positive rental income can be added to income, negative rental is treated as a liability

If a property was acquired since the last tax filing a current signed lease or rental agreement can be used

- Reduce the gross rental amount by 25% for vacancy and maintenance
- Subtract PITIA AND
- Apply the resulting amount to income if positive or recurring monthly liabilities if negative

Exclusion of Rental Income from Property Being Vacated by Consumer
When a consumer vacates a principal residence in favor of another principal residence rental income for qualifying may only be used in one of the two circumstances below:

Circumstance	Description
Relocation	• Consumer is relocating with new employer or being transferred by current employer to an area not within reasonable and locally-recognized commuting distance • A fully executed lease, must be signed by consumer and tenant • Lease must be at least a one year lease • Evidence of the security deposit and evidence that first month's rent was paid
Sufficient Equity in Vacated Property	• The LTV on the departing property is 75% or less • An appraisal no more than six months old is required to calculate LTV (UPB to original sales price) • The following appraisal forms are acceptable: o Full Appraisal: Fannie Mae 1004/Freddie Mac 70 o Exterior Only: Fannie Mae/Freddie Mac 2055 o Condo: Fannie Mae 1075/Freddie Mac

Non-Taxable and Projected Income

Types of Non-Taxable Income
May include, but not limited to:
- A portion of Social Security
- Federal government employee retirement
- Railroad Retirement Benefits
- Some State government retirement
- Certain types of disability
- Public Assistance
- Child support
- Military allowances

Adding Non-Taxable Income to Gross Income
A percentage of non-taxable income that may be added back cannot exceed the appropriate tax rate for the income amount

Additional allowances for dependents is not acceptable

The following are the steps to document:
- Document and support the amount of income grossed up for any non-taxable income source
- Apply the tax rate used to calculate the consumer's last year's income tax

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NOTE: *If the consumer is not required to file a Federal tax return, use 25%*

Consumer Liabilities: Recurring Obligations

Types of recurring obligations

- All installment loans
- Revolving accounts
- Real estate loans
- Alimony
- Child support
- And others

Debt to Income Calculation

Installment loans less than ten months must be included if the amount of the debt affects the consumer's ability to pay the mortgage during the months immediately after the loan closes, especially if the consumer will have limited or no cash assets after closing

If the credit report shows revolving accounts with an outstanding balance but no minimum monthly payment, the payment must be calculated as the greater of 5% of the balance or $10

NOTE: *If the actual amount is documented with a current statement reflecting the monthly payment, that amount may be used to qualify*

Reduction of Alimony Payment

Since there are tax consequences with alimony payments its possible to treat the monthly alimony obligation as a reduction from gross income, rather than treating it as a monthly obligation

Consumer Liabilities: Contingent Liability

A contingent liability exists when and individual is held responsible for payment of a debt if another party, jointly or severally obligated, defaults on the payment

Contingent liability - Mortgage assumption

A contingent liability must be considered when the consumer remains obligated on an outstanding FHA-insured, VA-guaranteed or conventional mortgage secured by property that has been sold or traded within the last 12 months without a release of liability or will be sold on an assumption without release of liability

Exemption from contingent liability - Mortgage assumption

When a mortgage is assumed, contingent liability need not be considered if:

- The originating creditor of the mortgage being underwritten obtains a payment

history showing that the mortgage has been current during the last 12 months OR
- The value of the property, as established by an appraisal or the sales price on the HUD-1 or Closing Disclosure from the sale has an LTV of 75% or less

Contingent liability – Cosigned Obligations
If the creditor can obtain documentation that the primary obligor has been making the regular payments during the last 12 months without delinquency, the cosigned payment may be excluded

Consumer Liabilities: Projected Obligations and Obligations not Considered Debt

Projected Obligations
Payments such as student loan or a balloon note scheduled to begin or come due within 12 months of the mortgage closing must be included in the DTI calculation

Projected payments may be excluded if the consumer provides written evidence that the debt will be deferred to a period outside of the 12-month timeframe

Obligations not Considered Debt
The following are examples of debt not included in DTI calculation:
- Federal, State and local taxes
- Retirement contributions – Including repayment of debt secured by these funds
- Union dues
- Open accounts with zero balances
- Child care
- Voluntary deductions