

Section E. Non-Employment Related Borrower Income

Overview

In This Section This section contains the topics listed in the table below.

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1. Alimony, Child Support, and Maintenance Income

Introduction This topic contains information on alimony, child support, and maintenance income requirements, including

- alimony, child support, and maintenance income criteria, and
 - TOTAL Scorecard Accept/Refer requirements for alimony, child support and maintenance income.
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Change Date March 1, 2011

4155.1 4.E.1.a Alimony, Child Support and Maintenance Income Criteria Alimony, child support, or maintenance income may be considered effective, if

- payments are likely to be received consistently for the first three years of the mortgage
- the borrower provides the required documentation, which includes a copy of the
 - final divorce decree
 - legal separation agreement,
 - court order, or
 - voluntary payment agreement, and
- the borrower can provide acceptable evidence that payments have been received during the last 12 months, such as
 - cancelled checks
 - deposit slips
 - tax returns, or
 - court records.

Notes:

- Periods less than 12 months may be acceptable, provided the lender can adequately document the payer's ability and willingness to make timely payments.
- Child support may be "grossed-up" under the same provisions as non-taxable income sources.

Reference: For more information on grossing-up, see HUD 4155.1 4.E.5.a.

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1. Alimony, Child Support, and Maintenance Income, Continued

**4155.1 4.E.1.b
TOTAL
Scorecard
Accept/Refer
Requirements
for Alimony,
Child Support
and
Maintenance
Income**

The Technology Open To Approved Lenders (TOTAL) Scorecard Accept/Approve and Refer recommendations for alimony, child support, and maintenance income require evidence

- of receipt, using deposits on bank statements or cancelled checks for the most recent three months that support the amount used when qualifying, and
- that the claimed income will continue for at least three years.

For the financial details, the underwriter should use the front and pertinent pages of the divorce decree, settlement agreement and/or court order.

Reference: For more information on the TOTAL Scorecard recommendations, see the [TOTAL Mortgage Scorecard User Guide](#).

2. Investment and Trust Income

Introduction This topic contains information on analyzing investment and trust income, including

- analyzing interest and dividends
 - trust income
 - notes receivable income, and
 - calculating qualifying ratios for investment properties.
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Change Date March 1, 2011

4155.1 4.E.2.a Analyzing Interest and Dividends Interest and dividend income may be used for qualifying as long as tax returns or account statements support a two-year receipt history. This income must be averaged over two years.

The underwriter should subtract any funds derived from these sources that are required for the cash investment, before calculating the projected interest or dividend income.

4155.1 4.E.2.b Trust Income Income from trusts may be used for qualifying if guaranteed, constant payments will continue for at least the first three years of the mortgage term.

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

- amount of the trust
- frequency of distribution, and
- duration of payments.

The borrower may withdraw funds from the trust account to use for the required cash investment if he/she provides adequate documentation that this withdrawal will not negatively affect the amount of trust income the underwriter used to determine repayment ability.

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2. Investment and Trust Income, Continued

4155.1 4.E.2.c
Notes
Receivable
Income

In order to include notes receivable income to qualify a borrower, he/she must provide

- a copy of the note, to establish the amount and length of payment, and
- evidence that these payments have been consistently received for the last 12 months, in the form of
 - deposit slips
 - cancelled checks, or
 - tax returns.

If the borrower is not the original payee on the note, the lender must establish that the borrower is now a holder in due course, and able to enforce the note.

4155.1 4.E.2.d
Calculating
Qualifying
Ratios for
Eligible
Investment
Properties

The underwriter should follow the steps in the table below to calculate an investment property’s income or loss, whether the property to be insured is an eligible investment property, or sold through FHA’s Real Estate Owned (REO) program.

Step	Action
1	Subtract the total monthly housing payment of principal, interest, taxes and insurance (PITI) from the monthly net rental income of the subject property. <i>Note:</i> Calculate the monthly net rental by taking the gross rents, and subtracting the 25% reduction, or the applicable Homeownership Center’s (HOC) percentage reduction for vacancies and repairs.
2	Does the calculation in Step 1 yield a positive number? • If <i>yes</i> , add the number to the borrower’s monthly gross income. • If <i>no</i> , include the number as a recurring monthly obligation.

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2. Investment and Trust Income, Continued

4155.1 4.E.2.d Calculating Qualifying Ratios for Eligible Investment Properties (continued)

Step	Action
3	Calculate the mortgage payment-to-income ratio (top or front-end ratio) by dividing the borrower's current housing expense on his/her principal residence by the monthly gross income. <i>Note:</i> The monthly gross income includes any positive cash flow from the subject investment property.
4	Calculate the total fixed payment-to-income ratio (bottom or back-end ratio) by dividing the borrower's total monthly obligations, including any net loss from the subject investment property, by the borrower's total monthly gross income.

3. Military, Government Agency, and Assistance Program Income

Introduction This topic contains information on analyzing military, government agency, and assistance program income, including

- military income
 - VA benefits
 - government assistance programs
 - mortgage credit certificates, and
 - Section 8 home ownership vouchers.
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Change Date March 1, 2011

**4155.1 4.E.3.a
Military
Income** Military personnel receive base pay, and are often entitled to additional forms of pay, such as

- variable housing allowances
- clothing allowances
- flight or hazard pay
- rations, and
- proficiency pay.

These types of additional pay are acceptable when analyzing a borrower's income as long as the probability of such pay to continue is verified in writing.

Note: The tax-exempt nature of some of the above payments should also be considered.

Reference: For information about non-taxable income, see HUD 4155.1 4.E.5.

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3. Military, Government Agency, and Assistance Program Income, Continued

**4155.1 4.E.3.b
VA Benefits** Direct compensation for service-related disabilities from the Department of Veterans Affairs (VA) is acceptable income for qualifying, provided the lender receives documentation from the VA.

Education benefits used to offset education expenses are *not* acceptable.

**4155.1 4.E.3.c
Government
Assistance
Programs** Income received from government assistance programs is acceptable for qualifying, as long as the paying agency provides documentation indicating that the income is expected to continue for at least three years.

If the income will not be received for at least three years, it may be considered as a compensating factor.

Unemployment income *must* be documented for two years, and there must be reasonable assurance that this income will continue. This requirement may apply to seasonal employment.

Reference: For information on analyzing income from seasonal employment, see HUD 4155.1.4.D.2.e.

**4155.1 4.E.3.d
Mortgage
Credit
Certificates** If a government entity subsidizes the mortgage payments either through direct payments or tax rebates, these payments may be considered as acceptable income.

Either type of subsidy may be added to gross income, or used directly to offset the mortgage payment, before calculating the qualifying ratios.

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3. Military, Government Agency, and Assistance Program Income, Continued

4155.1 4.E.3.e
Section 8 Home
Ownership
Vouchers

A monthly subsidy may be treated as income if a borrower is receiving subsidies under the housing choice voucher home ownership option from a Public Housing Agency. Continuation of the home ownership voucher subsidy beyond the first year is subject to Congressional appropriation, however, FHA has agreed that it will assume, for the purposes of underwriting, that the subsidy will continue for at least three years.

If the borrower is receiving the subsidy directly, the amount received is treated as income. The amount received may also be treated as non-taxable income and “grossed up” by 25%, which means that the amount of the subsidy, plus 25% of that subsidy may be added to the borrower’s income from employment and/or other sources.

Lenders may treat this subsidy as an offset to the monthly mortgage payment (i.e. reduce the monthly mortgage payment by the amount of the home ownership assistance payment before dividing by the monthly income to determine the payment-to-income and debt-to-income ratios).

As the subsidy payment must not pass through the borrower’s hands, the assistance payment must be

- paid directly to the servicing lender, or
- placed in an account that only the servicing lender may access.

Note: Assistance payments made directly to the borrower *must* be treated as income.

4. Rental Income

Introduction This topic contains information on analyzing rental income, including

- analyzing the stability of rental income
- rental income from borrower-occupied property
- income from roommates
- documentation required to verify rental income
- analyzing IRS Form 1040 Schedule E
- using current leases to analyze rental income
- the exclusion of rental income from a property being vacated by the borrower, and
- exceptions to the exclusion of rental income from a principal residence being vacated by a borrower.

Change Date March 1, 2011

4155.1 4.E.4.a Analyzing the Stability of Rental Income Rent received for properties owned by the borrower is acceptable income for qualifying as long as the lender can document the stability of the rental income through a(n)

- current lease
- agreement to lease, or
- rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal or military renters, or property rehabilitation).

A separate schedule of real estate is not required for rental properties as long as all properties are documented on the Uniform Residential Loan Application (URLA).

Note: The underwriting analysis may *not* consider rental income from any property being vacated by the borrower, except under the circumstances described in HUD 4155.1 4.E.4.h.

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4. Rental Income, Continued

**4155.1 4.E.4.b
Rental Income
From Borrower
Occupied
Property** The rent for multiple unit property where the borrower resides in one or more units and charges rent to tenants of other units may be used for qualifying purposes.

Projected rent for the tenant-occupied units may

- *only* be considered gross income, after deducting the Homeownership Center's (HOC) vacancy and maintenance factor, and
- *not* be used as a direct offset to the mortgage payment.

Reference: For information about the HOCs' vacancy and maintenance factors, see the [HOC Reference Guide](#).

**4155.1 4.E.4.c
Income from
Roommates in
a Single Family
Property** Income from roommates in a single family property occupied as the borrower's primary residence is *not* acceptable for qualifying. Rental income from boarders, however, *is* acceptable, if the boarders are related by blood, marriage or law.

The rental income may be considered effective if shown on the borrower's tax return. If not on the tax return, rental income paid by the boarder

- may be considered as a compensating factor, and
 - must be adequately documented by the lender.
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**4155.1 4.E.4.d
Documentation
Required to
Verify Rental
Income** Analysis of the following required documentation is necessary to verify all borrower rental income:

- [IRS Form 1040](#) Schedule E, as described in HUD 4155.1 4.D.5.b, and
 - current leases/rental agreements, as described in HUD 4155.1 4.E.4.f.
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4. Rental Income, Continued

4155.1 4.E.4.e Analyzing IRS Form 1040 Schedule E

[Schedule E](#) to the Internal Revenue Service (IRS) [Form 1040](#) is required to verify all rental income. Depreciation shown on Schedule E may be added back to the net income or loss.

Positive rental income is considered gross income for qualifying purposes, while negative income must be treated as a recurring monthly liability.

The lender *must* confirm that the borrower still owns each property listed, by comparing Schedule E with the Real Estate Owned section of the URLA. If the borrower owns six or more units in the same general area, a map must be provided disclosing the locations of the units, as evidence of compliance with FHA's seven-unit limitation.

Reference: For information about the FHA seven rental unit limitation, see HUD 4155.1 4.B.4.d.

4155.1 4.E.4.f Using Current Leases to Analyze Rental Income

The borrower can provide a current signed lease or other rental agreement for a property that was acquired since the last income tax filing, which is not shown on Schedule E.

In order to calculate the rental income

- reduce the gross rental amount by 25% (or the percentage developed by the jurisdictional HOC) for vacancies and maintenance
 - subtract PITI, and any homeowners' association (HOA) dues, and
 - apply the resulting amount to
 - income, if positive, or
 - recurring debts, if negative.
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4. Rental Income, Continued

**4155.1 4.E.4.g
Exclusion of
Rental Income
From Property
Being Vacated
by the
Borrower**

Underwriters may *not* consider any rental income from a borrower's principal residence that is being vacated in favor of another principal residence, except under the conditions described in HUD 4155.1 4.E.4.h

Notes:

- This policy assures that a borrower either has sufficient income to make both mortgage payments without any rental income, or has an equity position which makes it unlikely that he/she will default on the mortgage on the property being vacated.
- This applies *solely* to a principal residence being vacated in favor of another principal residence. It does *not* apply to existing rental properties disclosed on the loan application and confirmed by [Schedule E](#) of IRS [Form 1040](#).

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4. Rental Income, Continued

4155.1 4.E.4.h Exceptions to the Exclusion of Rental Income From a Principal Residence Being Vacated by a Borrower

When a borrower vacates a principal residence in favor of another principal residence, the rental income, reduced by the appropriate vacancy factor as determined by the jurisdictional FHA HOC, *may* be considered in the underwriting analysis, under the circumstances listed in the table below.

Reference: For information on jurisdictional HOC vacancy factors, see HOC Reference Guide, [Vacancy, Collection and Maintenance Cost Factors](#).

Exception	Description
Relocations	<p>The borrower is relocating with a new employer, or being transferred by the current employer to an area not within reasonable and locally-recognized commuting distance.</p> <p>A properly executed lease agreement (that is, a lease signed by the borrower and the lessee) of at least one year's duration after the loan is closed is required.</p> <p>Note: FHA recommends that underwriters also obtain evidence of the security deposit and/or evidence that the first month's rent was paid to the lessee.</p>
Sufficient Equity in Vacated Property	<p>The borrower has a loan-to-value (LTV) ratio of 75% or less, as determined by</p> <ul style="list-style-type: none"> • a residential appraisal no more than six months old, or • comparing the unpaid principal balance to the original sales price of the property. <p>Note: The appraisal may be an exterior-only appraisal using form Fannie Mae/Freddie Mac 2055, Exterior-Only Inspection Residential Appraisal Report or, for condominium units, form Fannie Mae 1075/Freddie Mac 466, Exterior-Only Inspection Individual Condominium Unit Appraisal Report.</p>

5. Non-Taxable and Projected Income

Introduction This topic contains information on analyzing non-taxable and projected income, including

- types of non-taxable income
 - grossing-up non-taxable income
 - analyzing projected income, and
 - projected income for a new job.
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Change Date March 1, 2011

4155.1 4.E.5.a Certain types of regular income may not be subject to Federal tax, such as

Types of Non-Taxable Income

- some portion of Social Security,
 - some Federal government employee retirement income
 - Railroad Retirement benefits
 - some state government retirement income
 - certain types of disability and public assistance payments
 - child support
 - military allowances, and
 - other income that is documented as being exempt from Federal income taxes.
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4155.1 4.E.5.b The amount of continuing tax savings attributed to regular income not subject to Federal taxes may be added to the borrower's gross income.

Grossing-Up Non-Taxable Income

The percentage of non-taxable income that may be added *cannot* exceed the appropriate tax rate for the income amount. Additional allowances for dependents are *not* acceptable.

The lender

- must document and support the amount of income *grossed-up* for any non-taxable income source, and
- should use the same tax rate the borrower used to calculate his/her income tax from the previous year.

Note: If the borrower is not required to file a Federal tax return, the tax rate to use is 25%.

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5. Non-Taxable and Projected Income, Continued

4155.1 4.E.5.c Projected or hypothetical income is *not* acceptable for qualifying purposes. Analyzing Projected Income However, exceptions are permitted for income from

- cost-of-living adjustments,
- performance raises, and
- bonuses

For the above exceptions to apply, the income must be

- verified in writing by the employer, and
 - scheduled to begin within 60 days of loan closing.
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4155.1 4.E.5.d Projected income is acceptable for qualifying purposes for a borrower scheduled to start a new job within 60 days of loan closing if there is a guaranteed, non-revocable contract for employment. Projected Income for a New Job

The lender *must* verify that the borrower will have sufficient income or cash reserves to support the mortgage payment and any other obligations between loan closing and the start of employment.

The loan is *not* eligible for endorsement if the loan closes more than 60 days before the borrower starts the new job. To be eligible for endorsement, the lender must obtain from the borrower a pay stub or other acceptable evidence indicating that he/she has started the new job.

Examples: A teacher whose contract begins with the new school year, or a physician beginning his/her residency fall into this category.
