

RD AN No.4474 (1980-D)
September 17, 2009

TO: State Directors
Rural Development

ATTENTION: Rural Housing Program Directors,
Guaranteed Loan Coordinators,
Area Directors and Area Specialists

FROM: Tammye Treviño (*Signed by Tammye Treviño*)
Administrator
Housing and Community Facilities Programs

SUBJECT: Single Family Housing Guaranteed Loan Program
Stable and Dependable Income

PURPOSE/INTENDED OUTCOME:

This Administrative Notice (AN) will assist the Agency and approved lenders to identify stable and dependable income sources that may be used for repayment consideration.

COMPARISON WITH PREVIOUS AN:

There is no previous AN issued.

EXPIRATION DATE:
August 31, 2010

FILING INSTRUCTIONS:
Preceding RD Instruction 1980-D

BACKGROUND:

The Single Family Housing Guaranteed Loan Program (SFHGLP) has three distinct income calculations that must be considered for program eligibility and repayment purposes by the Agency and approved lenders.

1. **Annual Income:** All income received by adult household members that will reside in the home in accordance with RD Instruction 1980-D, Section 1980.347.
2. **Adjusted Annual Income:** Annual income, minus eligible household deductions, determines whether the household is eligible for Guaranteed Loan benefits. Please reference RD Instruction 1980-D, Section 1980.348.
3. **Repayment Income (Qualifying Income):** The stable and dependable income verified by the approved lender that will be utilized to calculate housing and total debt ratios. Only the income of applicants that will be a party to the note will be considered. Please reference RD Instruction 1980-D, Section 1980.345(b) and 1980.345(c)(2).

This AN will assist approved lenders to determine whether income sources should be considered stable and dependable for repayment purposes. Income documentation required to be retained by the approved lender is not addressed in this AN.

IMPLEMENTATION RESPONSIBILITIES:

RD Instruction 1980-D, section 1980.345(c)(2)(i) states, in part:

“In considering qualifying income, the Lender must determine whether there is a historical basis to conclude that the income is likely to continue. Typically, income of less than 24 months duration should not be included in qualifying income.”

It is the approved lender’s responsibility to determine that the applicant’s income is stable, predictable, and likely to continue. The lender must use sound underwriting judgment in making this determination. The anticipated amount of income, and likelihood of its continuance, must be established to determine the applicant’s capacity to repay the loan.

Unless there is evidence that the income will no longer be received, the lender may assume that it will continue. An example of income not likely to continue would include child support that is received for a 16 year old dependent, but the support is court ordered to cease when the dependent reaches 18 years of age.

There is no minimum length of time an applicant must have held a position to consider employment income as dependable. Typically, when an applicant has been generating income for two or more years from either part time or full time employment, the lender may consider this income to be stable and dependable. However, information that will

help the lender to better understand the nature of the applicant's income, stability and the likelihood of continuance is not always available from the current paystub alone. Obtaining two years of documentation for an applicant's employment and income history will assist lenders in their analysis regarding probable stability and continuance of the income source. The applicant should not have any gaps in employment of more than a month, within the two year period, prior to making loan application. The lender may make allowances for seasonal employment such as construction or agricultural trades.

Some situations to consider where allowances may be reasonable:

1. Applicant has recently graduated from school or has spent time in the military, as evidenced by college transcripts or discharge papers. This type of applicant could be favorably considered, if adequate future income can be anticipated because their education and training will expand their job opportunities. Lenders must use extreme caution when an applicant's employment includes a probation period.
2. Many low and moderate income applicants change jobs frequently due to the nature of the employment available. Applicants should not be penalized for frequent changes in jobs if, despite the changes, income continuity has been maintained.
3. The applicant has recently re-entered the workforce after an absence to care for a family member or minor child, extended medical illness, or other circumstance reasonable to the lender.

Repayment Income Types

Income may come from many different sources. Salary and wage income is the most common and easiest to determine and verify. Income from other sources can be considered as repayment income, as long as the lender can properly document its stability and continuance. Sources of income that the lender cannot verify are not acceptable for the purpose of qualifying applicants for guaranteed loans

The following guidance will assist lenders to evaluate the stability and continuance of other types of income from sources other than wages and salaries. This list does not encompass all eligible income types that lenders may consider.

Overtime and Bonus Income: Income should be received for two years from the same employer in order to be considered stable and dependable. Averages from periods of less than two years may be acceptable provided the underwriter adequately justifies and documents their reason for including the income. When a lender verifies income, the employer must indicate that the overtime and bonus income has a probability to continue. If either type of income shows a continual decline, the lender must provide a sound rationale for the amount included as repayment income. If income from these sources

seem to vary significantly from year to year, a period of more than two years should be used in calculating average income.

Commissions: Commission income should be averaged over the previous two years from the same employer. Non-reimbursed expenses, if any, should be subtracted from the gross income reported on the borrower's tax returns. Commissions earned less than one year should not be considered as repayment income absent significant compensating factors. Exceptions may be made in those situations where the applicant's compensation was changed from a salary to commission, within a similar position, with the same employer. If commission income shows a decrease from one year to the next, significant compensating factors must be documented to include this income towards repayment ability.

Part-Time, Second Job and Seasonal Income: Income from a second or part-time job may be counted, if the applicant has worked this position uninterrupted for the past two years and will continue to do so. Seasonal employment (e.g. umpiring baseball games, working holidays at a department store, harvesting produce, etc.) may be counted, if the applicant has worked the same type of job for the past two years. The lender may consider income received for less than two years, if they can determine through employer verification the likelihood of continuance. If the employer cannot concur, income received less than two years may be utilized as a compensating factor for exceeding the debt ratios under RD Instruction 1980-D section 1980.345.

Tax-exempt Income: The standard debt-to-income ratios are based on an assumption the income is taxable. Income sources that are tax-exempt include, but are not limited to, social security, retirement, disability, child support, workers' compensation benefits, certain public assistance payments, military allowances, etc. The amount of continued tax savings attributable to the nontaxable income source may be added to the applicant's repayment income. The lender must verify that the particular source of income is non-taxable and that both the income and its non-taxable status are likely to continue. Section 1980.345(c)(2)(ii), of RD Instruction 1980-D, allows non-taxable income to be "grossed up" by the amount of federal tax savings attributable [the amount of tax that would normally be paid by a wage earner in a similar tax bracket] to the nontaxable income for repayment purposes only. No other adjustments for tax-exempt income are authorized.

Military Income: In addition to base pay, military personnel may be entitled to additional forms of pay. Income from variable housing allowances, clothing allowances, flight or hazard pay, rations, and proficiency pay may be used for repayment income provided it is verified as stable and likely to continue. An additional consideration may be the tax-exempt nature of some of these payments.

Child Support, Alimony, or Maintenance Income: Income in this category may be counted, if such payments are likely to continue for at least the first three years of the mortgage. Evidence the payments have already been received for the past 12 months must be documented. Payment periods of less than 12 months may be acceptable, if the lender can document the payer's ability and willingness to make timely payments.

Retirement and Social Security Income: Income should be verified to continue for at least the first three years of the mortgage. If any benefits will expire within the first three years of the proposed loan, the income source may only be considered as a compensating factor.

Interest and Dividends: Income should be received for the past two years and may be averaged based upon verified documentation. Any funds derived from these sources, and required for closing, must be subtracted before the projected interest or dividend income is calculated.

Employer Differential Payments: If the employer subsidizes the mortgage payments through direct payments, this is a housing allowance. The amount of these payments should be considered gross income to calculate ratios. It may not be used to directly offset the mortgage payment, even if the employer pays the servicing lender directly.

VA Benefits: Direct compensation from the U.S. Department of Veteran's Affairs (VA), (e.g., regular payments for a service-related disability), can be counted if the VA verifies it. VA education benefits used to offset education expenses are not an acceptable source of repayment income. The difference between the costs of education and the benefit, however, can be considered repayment income.

Government Assistance Programs: Income received under a government assistance program such as, unemployment income, workers' compensation benefits, payments for foster children, etc. can be counted as long as it is expected to continue for at least three years. If this income is not expected to last three years, it may be considered as a compensating factor. Unemployment income requires a two year documentation of its receipt and reasonable assurance of its continuance. This may be appropriate for individuals employed on a seasonal basis, such as farm workers or resort area employees.

Automobile Allowance and Expense Account Payments: The amount by which an applicant's automobile allowance or expense account payments exceed actual expenditures may be considered as repayment income. Income should be received for two years, along with verification from the employer that these payments will continue. The applicant's monthly car payment must be treated as a recurring debt and must not be offset by the car allowance.

Exceptions to Income: For those applicants about to start a new job, if the borrower has a firm offer letter from the new employer indicating the job will begin within 90 days of loan closing, the income can be considered when determining eligibility and repayment income. The lender must also verify that the applicant will have sufficient income, or cash reserves, to support the mortgage payments and any other obligations during the interim between loan closing and the start of employment. This may be appropriate for situations such as a teacher whose contract begins with the new school year, or a

physician beginning residency after the loan is scheduled to close. However, if the loan will close more than 90 days before the employment begins, the income cannot be counted for repayment purposes.

Income sources that a lender determines does not meet the definition of stable and dependable may be considered as a compensating factor for meeting debt ratios.

SUMMARY:

Rural Development expects that mortgages guaranteed will be repaid, via regular monthly payments, without servicing problems or the institution of foreclosure proceedings. Approved lenders are to make loans to applicants who can be expected to repay the debt without difficulty. Loans should not be made when the purchase will be burdensome or likely to result in default.

Many components make up the analysis of probable stability and continuance of income – the applicant’s occupation, employment tenure, opportunities for future advancement, educational background, and occupational training. Approved lenders should consider all aspects of the applicant’s income potential prior to approving a mortgage application. Proper evaluation of repayment income affects repayment ratios and determines the applicant’s ability to successfully repay the mortgage obligation.

This guidance applies to loans manually underwritten or with the assistance of Guaranteed Underwriting System (GUS). GUS does not evaluate the stability and dependability of repayment income in the underwriting recommendation. The approved lender must make their analysis prior to approving a mortgage loan and ensure all documentation to support the approval is retained in the lenders loan file.

Questions regarding this AN may be directed to Kristina Zehr at (309) 452-0830, ext. 111, or Joaquin Tremols at (202) 720-1452. Their respective email addresses are kristina.zehr@wdc.usda.gov and joaquin.tremols@wdc.usda.gov.