

Employment, Income Analysis & Documentation rev. 10 Revised 7/2/2013

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**Overview /
General**

Correctly evaluating the borrower's employment and income is a key component in determining the ability and capacity to repay the mortgage obligation, as well as all other monthly obligations. In order for income to be considered, it must be deemed stable, adequate and expected to continue.

The borrower should have a consecutive 2-year history of income, with the same employer, for the income to be considered stable. However, income may be acceptable and considered stable if the loan file contains supporting documentation, explanations and rationale analyzed by the underwriter and there is reasonable justification to support income from a borrower who has:

- Employment history less than 2 years
- Frequent job changes
- A gap in employment
- A change in employer

A two year history, including all employers or income sources, should be documented on the application (10003).

All loan files must contain an income analysis completed by the underwriter, which may be supplemented with the use of tools such as Fannie Mae's Comparative Income Analysis Form 1088 or Cash Flow Analysis 1084. Any program specific differences will be referenced in the program guidelines.

Note: Loans with Mortgage Insurance are subject to meeting the MI Company's guidelines which may be different.

**Underwriting
Methods**

Guidelines contained in this document are applicable to loans underwritten by Desktop Underwriter (DU) and Loan Prospector (LP) unless otherwise stated. Regardless of underwriting method, additional information may be requested at the discretion of the underwriter.

Automated Underwriting

- Loans underwritten by Desktop Underwriter (DU) or Loan Prospector
 - Loans underwritten by Desktop Underwriter (DU) and Loan Prospector (LP) may follow the AUS Feedback Certificate with the exception of (LP) Streamlined Accept Feedback Certificate, unless otherwise stated in Plaza's Program Summaries.

**Employment
& Income
Stability and
Continuance**

In determining what is "stable" income, underwriters must be able to conclude, based on all sources and documentation verifying the income, that it can reasonably be expected to continue for the next 3 years.

The probability of consistent compensation should be considered to determine stability on a case-by-case basis. In addition, a move from dependence on public assistance to

earned income should be considered a positive factor in determining income stability. If a borrower does not meet the employment history requirement for the 2 full years prior to the date of the loan application, and was previously in school or the military, obtain copies of borrower diploma/transcripts or discharge papers.

Automated underwriting recommends acceptable levels of documentation, which may not be adequate for every borrower and every situation (such as long periods of unemployment). In these cases, additional documentation may be required.

Many factors contribute to an assessment of stability including:

- Education
- Training
- Technical skills
- Occupation
- Past employment history

Consider both the length of the borrower's employment with any 1 employer and the stable and reliable flow of income. When evaluating a borrower who has frequent job changes or unemployment, focus on whether the changes have affected the borrower's ability to repay their obligations.

If the borrower provides documentation of a consistent level and type of income and the ability to pay his/her obligations despite changes in the source of that income, it can be presumed that the borrower's income level is stable.

Known economic conditions, such as plant closings, company bankruptcies, etc. that may affect the borrower's income, must be taken into consideration. The amount of income claimed by the borrower must be reasonable for the borrower's position/job title, education, age, assets, and geographic location.

Special attention should be paid to the income feasibility by reviewing the credit report, credit profile and examining the bank statements for income/deposit patterns.

A level or upward trend in earnings must be established. Any decreases or significant increases could affect the stability of the borrower's income and would require a satisfactory explanation. If a satisfactory explanation cannot be provided, the income will be considered questionable and should not be used to qualify the borrower.

Borrowers who change jobs for advancement and maintain a stable earning capacity and good credit history, as well as borrowers with demonstrated job stability, will be eligible. Education or training to enhance job opportunities and income will receive favorable consideration.

**Earned
Income**

Stable earned income primarily consists of employment base pay (salary or hourly earnings). A minimum of 2 years employment history and continuance of income for 3 years is generally required for all borrowers whose income is being used to qualify.

If a borrower's employment history includes unemployment, the application must reflect at least 2 years of employment, therefore covering a longer period of time.

**Secondary
Earned
Income**

Secondary earned income must be verified and substantiated by the borrower's previous 2-year's earnings history. Types of secondary income include:

- Bonus
- Commission
- Overtime
- Second Job or additional part-time employment
- Self-Employed income

**Non-
Employment
Income**

Income from 1 of the following may be considered stable monthly income if it is likely to continue over the next 3 years:

- Alimony or child support
- Automobile/expense account
- Boarder income
- Capital gains
- Employment related assets
- Foreign income
- Foster-care
- Military base pay, clothes allowance, combat pay, flight pay, hazard pay, overseas pay, prop pay, quarters allowance, rations allowance, variable housing allowance
- Mortgage credit certificates (MCC)
- Mortgage differential payments income
- Notes receivable and installment debt
- Other types of income
- Pension and retirement income
- Royalty payment
- Seasonal income
- Social Security / Disability income
- Temporary leave
- Tip income
- Trust income
- Unemployment and public assistance income
- VA benefits (non-education)

To help make this determination, underwriters should consider:

- Whether the payments are received because of a written decree, court ruling, or law.
- How long and how regularly the payments have been received.
- Availability of procedures or processes to enforce future payments.

- Whether full payment has been made.
- For child support, the age of the child for which benefits are received.
- If there are eligibility criteria, such as age of dependents or accumulation of assets, governing the receipt of the income.
- The credit worthiness of the payer, if available.

**Employment
Gaps**

The stability of employment and income and its likelihood of continuance should be factored into the underwriting decision when there are gaps of employment.

Desktop Underwriter (DU) Loans

- Written letters of explanation for employment gaps are not required. However, borrower's re-entering the workforce with less than 6 months employment should be carefully reviewed to ensure a 2-year work history prior to the absence from the workforce is established.
- Additional documentation may be required (documentation supporting job loss, prior employment in same or related field, education or training supporting new job, etc.).

Loan Prospector (LP) Loans

- Written letters of explanation for employment gaps over 60 days in the last 2 years is required.
- In addition, borrowers who are re-entering the workforce after an extended absence may have stable employment if the following are met:
 - The borrower has been employed in his or her current job for 6 months or more.
 - A 2-year work history prior to the absence from the workforce is documented.

**Furloughed
Borrowers**

Employee furloughs are mandatory time off from work with no pay. Used as an alternative to a layoff, employee furloughs can occur in both public and private sector organizations.

In mandatory employee furloughs, employees take unpaid or partially paid time off of work for periods of time. The employees generally have either scheduled time off or call back rights and expectations.

Borrowers on mandatory furlough and are not working at all must return to work prior to the closing of the mortgage loan in order to use the employment income for qualifying purposes.

Borrowers on mandatory furlough who are working adjusted and/or reduced schedules and receiving reduced pay may be considered if qualifying employment income can be determined and verified with a likelihood of continuance.

Verification documentation may include, but is not limited to the following:

- Satisfactory written or verbal VOEs
- Satisfactory letters from employers, and/or
- Satisfactory payroll documents (i.e., paystubs/payroll ledgers, etc.).
- In all cases, the terms of the furlough must be documented in the loan file.

Documentation Age All employment and income documents must be dated no more than 90 days old on the date the Note is signed. For new construction, the employment and income documents must be no more than 120 days old on the date the Note is signed.

Documentation Standards Each income documentation form and their respective requirements are discussed below:

- Paystubs
- W-2's
- Written Verification of Employment
- Verbal Verification of Employment (Verbal VOE)
- Personal Tax Return
- Tax Information Authorization IRS Form 4506-T/Tax Transcripts
- Plaza's Income Calculation Worksheet

Paystub Regardless of the AUS findings, Plaza requires at a minimum a paystub for each qualifying borrower.

The paystub must clearly identify the following:

- Borrower as the employee.
- Gross earnings for the current pay period and year-to-date earnings must cover the most recent 30-day period.
- Reflect pay period.
- Employer name.
- If the borrower is paid hourly, the number of hours must be noted on the paystub.
- Paystubs must not have any alterations.
- Paystubs must be dated no earlier than 30 days prior to the loan application.
- Paystubs must be computer generated or typed.
- If the employer does not provide an acceptable computer generated or typed paystub; the employer must provide a payroll ledger and complete a written VOE that must be supported by the most recent year's income tax return and W-2.

Paystubs that are issued electronically, via e-mail or downloaded from the Internet are acceptable and must include the following:

W-2's

W2 is a IRS documentation of a borrower's income and must include the following:

- The W-2 must clearly identify the borrower as the employee and the employer name.
- Should be the employee copy provided by the employer.
- W-2's must be computer-generated or typed.
- W-2's must not have any alterations.
- Written Verification of Employment.

**Verification
of
Employment
(Fannie Mae
Form 1005)**

Must contain the following information:

- Dates of employment.
- Position held by the employee/borrower.
- Prospect of continued employment, when available.
- Base pay amount and frequency; for employees paid on an hourly basis, the verification must state the hourly wages, including the number of hours worked each week.
- Additional salary information, which itemizes bonus, overtime, tip, gratuity, or commission income, if applicable.
- A paystub and W-2 must support all written verifications of employment. Written verifications of employment are not acceptable as standalone documentation to substantiate the borrower's current employment/income regardless of the automated underwriting requirements.
- If a verification of employment is used, mail directly to the employer to the attention of the personnel department. Verifications of employment should never be mailed to a Post Office Box or to an individual's attention. If the borrower indicates this is necessary, the file must contain verification that the employer was independently contacted and verified this requirement
- The return address on the verification must be the lender's address. The hand carrying of verifications is strictly prohibited.

**Verbal
Verification
of
Employment -
Hourly,
Salary, and
Commission
Income (Non-
Military)**

Independently obtain a phone number and, if possible, an address for the borrower's employer. This can be accomplished by using a telephone book, the Internet, directory assistance, or by contacting the applicable licensing bureau.

Contact the employer verbally and confirm the borrower's current employment status on the Note date or within 10 business days prior to the Note date.

- If the employer confirms the borrower is currently on temporary leave, the lender must consider the borrower "employed." The conversation must be documented.

To comply with a verbal verification of employment (or telephone confirmation) requirement, independently obtain the phone number and address for the borrower's employer. This can be accomplished using a telephone book, directory assistance, the Internet (i.e. 411.com, yellowpages.com, etc.), or by contacting the applicable licensing bureau.

Requirements

A verbal verification of employment must contain the following information:

- Date of contact.
- Borrower's date of employment.
- Borrower's employment status and job title.
- Name, phone number and title of individual contacted at entity.
- Name of the entity contacted.
- Name and title of associate contacting employer.
- Method and source used to obtain the phone number.

Exceptions

If the employer will not verbally verify employment, the lender can obtain a written verification (other than an additional paystub) confirming the borrower's current employment status within the same time frame as the verbal VOE requirements. The written documentation must include the name and title of the person who completed the verification for the employer.

If the employer uses a third party employment verification vendor, the lender must obtain written verification from the vendor of the borrower's current employment status within the same time frame as the verbal VOE requirements.

Note: Because third-party vendor databases are typically updated monthly, the verification must evidence that the information in the vendor's database was no more than 35 days old as of the note date.

Negative Information

Negative comments received from an employer could be a reason to decline the application. However, prior to doing so, the underwriter must perform a detailed investigation of the comments, arrive at a precise reason to support the decision, and document the decision in writing.

Verification of Military Personnel Employment

If the borrower is in the military, in lieu of a verbal or written VOE, the lender must obtain either:

- A military Leave and Earnings Statement dated within 30 calendar days prior to the Note date (or 31 days for longer months), **OR**
- A verification of employment through the Defense Manpower Data Center (<https://www.dmdc.osd.mil/appj/mla/>).

Self- Employed Income

Verify the existence of the borrower's business within 30 calendar days prior to the Note date from a third party, such as a CPA, regulatory agency, or the applicable licensing bureau, if possible; or by verifying a phone listing and address for the borrower's

Verification business using a telephone book, the Internet, or directory assistance.

- The file must contain documentation for the source of the information obtained and the name and title of the lender's employee who obtained the information.

**Self
Employed
Verification
Alternatives**

If the borrower is a sole proprietor and does not use a CPA or accountant and the file contains validation that no business license is required, verification of the business and source of income is still required. Alternative verification includes copies of current contracts, invoices or business references and all of the following:

- Verbal verification to confirm the validity of any documents received, independent validation of the phone number for the contract, invoice or business reference prior to confirmation of the validity of the documents provided; **AND**
- Verification of a phone number listing and address for the borrower's business using a telephone book, the Internet (i.e. 411. com, yellowpages.com, etc.), directory assistance, or by contacting the applicable licensing bureau.

If the borrower is a sole proprietor and does not have a business phone number listing but uses a personal cell phone or home phone number, call the phone number to ensure it is in service and answered by the borrower or in the name of the business. Document the call in the loan file.

**Verbal VOE
for Seasonal
Employment**

Verify that the borrower has worked in the same job (or the same line of seasonal work) for the past 2 years. The employers in these cases should still have the ability to be contacted for employment verification purposes even if when verified it is during a down time part of the season.

- Confirm with the borrower's employer that there is a reasonable expectation that the borrower will be rehired for the next season.
 - Example, when schools are closed (i.e., summer break), it is important to remember that many school systems have staff members working during the extended closures that would be authorized to complete a VVOE.

**Third Party
Vendor
Verification**

If using a third party service to verify employment (e.g., The Work Number, Quick Confirm, etc.), the following policy applies:

- If the verification is obtained within a 10-business day period, it is measured from the date of the Client's request to the vendor, not the date the information was

updated in the vendor's database. However, the information from the database must have been updated within the last 35 calendar days. **OR**

- Obtain a written verification of employment (WVOE) sent directly to the employer.

Tax Returns The following standards apply when using Personal Tax Returns to verify income:
Personal Tax Returns must be:

- Complete with all schedules and W-2's, 1099s, K-1 schedules, etc.
- Signed and dated
- Borrower's copy filed with the IRS.
- Business Tax Returns must be:
 - Complete with all schedules
 - Signed and dated
 - Borrower's copy filed with the IRS

Tax Returns Filed After the Loan Application Date Tax returns filed after the application date may be acceptable when accompanied by the following:

- A letter of explanation regarding the reason for the re-file
- Evidence of filing.
- Payment and the ability to pay the tax if the check has not been cancelled.

Amended Tax Returns Tax returns that are amended and filed by the borrower with the IRS are acceptable in the following circumstances:

- Tax Returns Filed Prior to the Loan Application Date
- Tax returns filed prior to application are acceptable for underwriting purposes.
- Both the original filed return and the amended return are required. If the file was amended 60 days or less prior to the application, evidence of payment must also be provided.

Closely examine the original tax return and the amended tax return for consistency with previous filings to determine whether the use of the amended return is warranted. If the borrower requires the amended income for qualification, an exception must be submitted and approved for the use of the amended income. A copy of the original and amended tax returns must be submitted with the exception. When using an amended return after application, the underwriter must provide justification and commentary on the Transmittal Summary.

4506T / IRS Tax Transcripts Requirements The 4506-T will be processed and validated, prior to loan documents being ordered, to support the borrower's qualifying income. The 4506-T is required for all borrowers on the loan regardless of whether the borrower is providing tax returns as part of the qualifying process.

4506-T may not be used in lieu of a borrower's tax returns or W-2's.

The 4506-T transcripts are not required to be processed for borrowers who are newly employed and were full-time students immediately prior to the new employment. Borrowers must provide school transcripts to document they were a full-time student during the most recent tax year and immediately prior to new employment. The signed IRS 4506-T form is still required in the loan file.

IRS Transcripts must be obtained for the years of income documented in the file per the AUS findings. ([see chart below](#))

In instances where transcripts are not available for the most recent year documented, the Underwriter must obtain the same number of years transcripts required, using the most recent years available.

IRS Transcript Documentation Requirements (years noted are for example only and may differ from actual years being verified).

Income documentation required per AUS findings	Number of years validated IRS 4506T transcripts required
YTD paystub	1 year
YTD paystub and most recent year W-2	1 year
YTD paystub and most recent 2 years W-2's	2 years
Personal 1040's for most recent year	1 year
Personal 1040's for most recent 2 years	2 years
Personal 1040's and business returns for most recent 2 years	2 years
Income documents required on Jumbo and Manually Underwritten loans	Number of years validated IRS 4506T transcripts required
Salaried Borrowers: YTD Paystub 2 most recent W-2	2 years
Self Employed Borrowers Sole Proprietor: 2 years personal 1040's, 2 years business returns (when applicable) and YTD P&L	2 years
Self Employed (Corp, S-Corp or Partnership) 2 years personal 1040's and YTD P&L	2 years

If the IRS returns "no transcripts available" for the time period requested, proof of extension for loans closed after April 15th, and the most recent years IRS transcripts available based on the above chart are required.

Generally, IRS transcripts are available from the IRS as follows:

- Paper filing: 6-8 weeks from receipt by the IRS.
- E-filing: 15 days from receipt by the IRS.
- W-2 transcripts: Available beginning April 1.
- Before April 15, 2013, if borrower has not filed their 2012 tax returns, obtain the number of years income documentation according to the AUS funding's.

Salaried Borrowers Example

- If AUS requires 1 year documentation, obtain 2011 tax transcripts, current YTD paystub, and 2012 W-2's. (an attempt should be made to obtain the 2012 W-2's).
- If AUS requires 2 years documentation, obtain 2011 and 2012 tax transcripts, current YTD paystub, and 2011 and 2012 W-2's. (an attempt should be made to obtain the 2012 W-2's).
- If AUS requires a current paystub, obtain the 2012 tax transcripts and current YTD paystub. NOTE: The 2012 W-2 may be required by the underwriter based on the overall analysis of the loan.

Self Employed Borrowers Example

- If AUS requires 1 year documentation, obtain 2011 tax returns and IRS tax transcripts.
- If AUS requires 2 years documentation, obtain 2010 and 2011 tax returns and tax transcripts.
- A 2012 P&L (audited or unaudited) will be required to validate the stability or continuance of the borrower's income.
- After April 15, 2013, for borrowers who have filed an extension with the IRS, the following documentation is required:
- Evidence the extension was filed, AND
- Evidence from the IRS stating "no transcripts available" or "no record of return filed".

Borrowers not required to file tax returns

- If a borrower is not required to file a tax return – therefore income can not be validated through IRS 4506T transcripts, alternative documentation must be obtained. Examples of documentation include 1099 transcripts or an award letter with a bank statement to support the income being used.
- Transcripts for the following borrowers may not be available, or may not reflect all of the income being used to qualify:
 - Borrowers without qualifying income.
 - Borrowers with income from non-taxable sources (example: child support).

Borrowers who are exempt from filing tax returns based on income being below IRS published minimum income levels. 4506T must still be executed and an attempt to obtain transcripts must be made to confirm that the borrower does not file tax returns.

Using Recent Income when transcripts are not available

- When IRS transcripts are not available for the most recent year of income being used to qualify the borrower, the income may still be used provided material year over year income increases are explained and documented.

Use the guidance below to assess if the most recent years income can be included in qualifying when the most recent IRS transcripts are not available.

If earnings shown on most recent tax year are....	Eligibility
0 to 10% greater than previous years transcripts	The loan is eligible for financing. A satisfactory explanation may be required at the Underwriters discretion. If tax returns are provided and taxes are owed for the most recent year – the borrower must provide evidence the taxes have been paid.
Wage Earner: More than 10% greater than previous years transcripts	The loan may be eligible for financing based on the % of increase, the explanation, and the supporting documentation for the increase. Situations where this may occur include: <ul style="list-style-type: none"> • Wage earning spouse who is not on the transaction. • Borrower has an additional wage earning job not used. • Bonus income, raise, or a job change.
Self Employed: More than 10% greater than previous years transcripts	The loan will NOT be eligible for financing until the most recent years tax transcripts can be validated. If taxes are owed for the most recent year – the borrower must provide evidence the taxes have been paid.

Comparing Transcripts to Income Documentation

Comparing the Tax Returns to the IRS transcripts

- When tax returns are provided to document income, the tax returns must match the IRS transcripts.
- If the IRS transcripts do not match the tax returns, an explanation from the borrower for the discrepancy along with a copy of the filed amended returns will

- be required. Validation of returns will be required per the chart on page 1.
- Amended tax returns will only be accepted on a case by case basis, and should be submitted to a Level 5 underwriter or Corporate UW for review.

Comparing the W-2's to the IRS transcripts

- When W-2's are used to document income, they must be compared to the Wages, Salaries, and Tips section of the IRS transcript.
- If the transcripts show lower income than the W-2's, proof of an amended tax return must be provided and the validation of returns will be required per the chart above.
- If the transcripts show higher income, the UW should address and document the discrepancy. Situations where this may occur include but are not limited to:
 - Wage earnings of a spouse who is not on the transaction.
 - Borrower who has an additional wage earning (2nd) job that is not being used to qualify or was not disclosed.

Comparing the paystubs and written VOE's to the IRS transcripts

- When paystubs or written VOE's are the only income documentation provided in the file, they must be compared to the Wages, Salaries, and Tips section of the IRS transcripts to determine that the current income being used is not significantly different than the income on the IRS transcripts.
- If the income being used to qualify based on the paystubs or a written VOE is greater than 10% higher than the income documented on the IRS transcripts, the borrower will be required to provide an explanation for the discrepancy and additional income documentation to support the explanation should be provided.
- A greater than 10% increase may be due to the following:
 - Bonus Income
 - A raise
 - A job change

Additional IRS Transcript Guidance

The IRS transcripts should be reviewed for discrepancies that may require additional documentation or re-calculation of income. Additional reasons for discrepancies can include but are not limited to:

- Undisclosed 2106 expenses (un-reimbursed employee business expenses).
- Rental property income/loss.
- Capital gains income/loss.

In addition to reviewing the IRS transcripts for variances with income documentation in the file, the transcripts should be reviewed to identify and address any additional discrepancies or red flags. These include but are not limited to:

- Undisclosed self employment.
- Occupancy issues identified by address discrepancies.
- Undisclosed properties – may show up on the Schedule A Mortgage Interest deduction or on the Schedule E as a rental property.
- Undisclosed dependents.

**Income
Analysis
Forms**

The following Income Analysis form is preferred for all transactions, Plaza Income Worksheet.

**Income
Types**

Income types are defined as follows and detailed throughout this section

- Wage Earners
- Second Job or Multiple Job Employment
- Part-Time
- Overtime
- Bonus
- Commission
- Self-Employed Income
- Rental Income

Plaza requires at a minimum the following documentation

- Paystub for all borrowers whose income is used to qualify, regardless of AUS Findings.
- The 4506-T is required for all borrowers on the loan regardless of whether the borrower is providing tax returns as part of the qualifying process.
- Verbal Verification of Employment

**Wage Earner
/ Salaried
Income**

Generally, a non-self-employed borrower receives a W-2 at the end of the year that summarizes their total earnings. Includes borrowers that receive wages in the following categories:

- Hourly
- Weekly
- Bi-weekly
- Part-time
- Seasonal
- Bonus
- Commissions
- Tips/Gratuity

Wage Earner/Salaried borrowers have less than 25% ownership in the business from which they receive compensation.

The following documentation is required for salary and hourly income:

- DU requires each category of income be properly entered in DU (i.e., base, overtime, commission, retirement, etc.). DU findings will specify the documentation required.
- For LP loans, all income can be grouped together, regardless of the category.

While **DU/LP** will determine the minimum income verification documentation required, that level of documentation may not be adequate for every borrower and every situation and additional documentation is warranted and should be requested by the underwriter.

Hourly Income

Pay is on an hour-by-hour basis at a certain rate. Hourly employees are also considered to be eligible for overtime, according to federal law, if they work over 40 hours in a work week. Borrowers are typically paid weekly or biweekly. Includes employees that are part time, seasonal or receive tips/gratuity.

Note: Typically Hourly Income will be averaged over a period of time. This is because hours worked can vary from week to week. Determined at the underwriters discretion.

Second Job

Specific program guidelines may require additional documentation for Second Job or Multiple Job Employment.

- A borrower must have at least 2 years, uninterrupted history on all second or multiple jobs in order to include the income for qualification purposes.
- If this income is received for less than 2 years, it may be considered as a compensating factor only.
- Income will be averaged over the past 24 months.
- Desktop Underwriter (DU) Loans: (DU) requires a 12-month history of receipt of second job or multiple job employment. Follow automated underwriting documentation requirements.
- Loan Prospector (LP) Loans: Follow automated feedback certificate for documentation requirements.

Note: The second job must have a high probability of continuance for a minimum of 3 years.

Part Time Employment

Income must be verified as having been uninterrupted for the previous 2 years, with a strong likelihood to continue for the next 3 years.

Documentation must be on a Verification of Employment (Form 1005) covering 2 full years or must be supported by W-2 forms and a current pay stub or salary voucher with year-to-date earnings for the most recent 30 days.

**Overtime
Income**

The borrower must have a 2-year consecutive history of receiving overtime income and the income must be likely to continue for the next 3 years. While fluctuations in overtime income are expected, overtime that shows a significant declining trend is not considered stable.

The following documentation must be obtained to show a history of receipt of overtime income:

- Written Verification of Employment (VOE) covering the most recent 2 years with a breakout detailing the amount of overtime income and must indicate that overtime is expected to continue as outlined below. **OR**
- Most recent year-to-date pay stub documenting at least 30 days of income with a breakout detailing overtime income; and W's 2 covering the most recent 2 years. **OR**
- The Work Number® Web Site with full verification that includes a breakdown of income type and amount.

Determining Amount of Overtime Income to be Used as Qualifying Income

AUS Approve/Accept with standard documentation

- Use the average overtime income over the past 24 months if the borrower's prior 2 years and year-to-date annualized overtime income.
- Show that overtime income has been consistent or moderately increased each year.
- Use the average overtime income over the past 12 months if the borrower's prior 2 years and year-to-date annualized overtime income shows that overtime income has moderately decreased.
- If the overtime income shows a significant increase or decrease over the prior 2 years, an underwriter must individually assess the overtime income history to determine the appropriate calculation method.
- Refer to [Significant Increase or Decrease in Variable Income](#) in this section.
- While fluctuations in overtime income are expected, overtime that shows a significant declining trend is not considered stable and therefore may only be used as qualifying income if the loan file contains documentation and supporting rationale by an underwriter that the income has stabilized at the lower level.

AUS Approve/Accept with streamlined documentation

- When the AUS certificate only requires that 1 (rather than 2) years of prior overtime income be documented as outlined below, assume the overtime income has been earned as of the date of the paystub.

- A conservative method that assumes that total year overtime income has been earned as of the date of the pay stub must be used when AUS only requires that 1 (rather than 2) years of prior year overtime income be documented as outlined below. Divide the amount of YTD overtime income on the YTD paystub by 12. Example: If the paystub is dated June 30 and shows YTD overtime payments of \$6,000, then \$500 would be the monthly qualifying income (\$6000 divided by 12).
- If the YTD paystub does not reflect any overtime income receipt, then you will be unable to determine the likelihood of overtime continuance, and overtime income may not be used.
- If the borrower does not qualify under this more conservative method, additional documentation must be obtained to determine the actual frequency of the overtime income.

The underwriter may then calculate the income divided by the verified/actual frequency of the income. It may be determined that the 24 month calculation above would be more appropriate.

**Bonus
Income**

When bonus income is used as qualifying income, the borrower must have a 2-year consecutive history of receiving bonus income and the income must be expected to continue for the next 3 years. A signing bonus agreement or letter is not eligible to be considered as qualifying bonus income.

The following documentation must be obtained to show a history of receipt of bonus income:

- **Documentation required from current employer**
 - Written Verification of Employment (VOE) covering the most recent 2 full years with a breakdown of the bonus income and must indicate that bonus incomes is expected to continue as outlined below. **OR**
 - Most recent year-to-date paystub documenting at least 30 days of Income.
 - W-2's covering the most recent 2 years.
 - Verification that bonus income is expected to continue either in the written VOE or in a separate written statement from the employer. **OR**
 - The Work Number® Web Site with full verification that includes a breakdown of income type and amounts.
 - Verification that bonus income is expected to continue either in the written VOE, or in a separate written statement from the employer.
- **AUS Approve/Accept with streamlined documentation**
 - When the AUS certificate only requires that 1 (rather than 2) year of prior bonus income be documented as outlined below, assume the payment frequency is annual.
 - Divide the amount of YTD bonus income on the YTD paystub by 12. Example: If the paystub is dated June 30 and shows YTD bonus payments of \$6,000, then \$500 would be the monthly qualifying income (\$6000 divided by 12).
 - If the YTD paystub does not reflect any bonus income receipt, then full bonus

income documentation for prior 2 years must be obtained using qualification method outlined above.

- If the borrower does not qualify under this more conservative method, additional documentation must be obtained to determine the actual frequency of the bonus income.
- The underwriter may then calculate the Income, divided by the verified/actual frequency of the income. It may be determined that the 24 month calculation above would be more appropriate.

If the bonus income shows a significant increase or decrease over the prior 2 years, the underwriter must individually assess the bonus income history to determine the appropriate calculation method. Reference the significant increases or decreases in income level section within this guideline.

**Commission
Income**

The borrower must have a 2-year consecutive history of receiving commission and the income must be likely to continue for the next 3 years.

The following documentation must be obtained to show a history of receipt of commission income:

- Written Verification of Employment (VOE) covering the most recent 2 years with a breakout detailing the amount of commission income and must indicate that commission income is expected to continue as outlined below; plus
- Complete signed individual federal tax returns with all schedules for the most recent 2 years. **OR**
- Most recent year-to-date paystub documenting at least 30 days of income with a breakout detailing commission income; **AND**
- W-2's and/or 1099s covering the most recent 2 years; **AND**
- Complete signed individual federal tax returns with all schedules for the most recent 2 years. **OR**
- The Work Number® Web Site with full verification that includes a breakdown of income type and amounts; **AND**
- Complete signed individual federal tax returns with all schedules for the most recent 2 years.
- Employee-paid (unreimbursed) business expenses reflected on the borrower's tax returns must be deducted from the gross commission income when calculating income.
- If the AUS certificate requires only tax return(s) to verify commission income and it has been more than 60 days since the filing date of the most recent tax return, also obtain a current paystub or IRS Form 1099 to assist with confirming that Current earnings support the income on the tax returns.

- If the loan is originated between January 1st and April 15th and the borrower has not yet filed a tax return for the prior year, also obtain either an IRS Form 1099 or W-2 for the previous year.

Determining Amount Of Commission Income To Be Used As Qualifying Income

AUS Approved Loans with Standard Documentation

- After deducting any employee paid business expenses reflected on the borrower's tax returns from gross commission income, use the average income over the past 24 months if the borrower's prior 2 years and year-to-date annualized commission income show that commission income has been consistent or moderately increased each year.
- Frequency of commission payments must be confirmed in order to annualize the commission amount from the year-to-date pay stub.
- If the commission income shows a significant increase or decrease over the prior 2 years, an underwriter must individually assess the commission income history to determine the appropriate calculation method.
- Refer to Significant Increase or Decrease in Variable Income in this section.

AUS Approved Loans with Streamlined Documentation

- If only the most recent tax return is required by the AUS to verify commission income, divide the amount of commission income less any employee (un-reimbursed) paid business expenses by 12 regardless of the number of months reflected on the most recent tax return.
- The tax return(s) must reflect a minimum of 6 months commission earnings in order to be considered as qualifying income.
- If only a YTD paystub is required by the AUS to verify commission income, assume the frequency of commission payments is on an annual basis
- Divide the amount of YTD commission income on the YTD paystub by 12.
Example: If the paystub is dated June 30 and shows YTD commission payments of \$6,000, then \$500 would be the monthly qualifying income (\$6000 divided by 12).
- If the YTD paystub does not reflect any commission income receipt, then full commission income documentation for the prior 2 years must be obtained using the qualification method outlined above.
- If the borrower does not qualify under this more conservative method, additional documentation must be obtained to determine the actual frequency of the commission income.
- The underwriter may then calculate the income divided by the verified/actual frequency of the income. It may be determined that the 24 month calculation above would be more appropriate.

- If the commission income shows a significant increase or decrease over the prior 2 years, an underwriter must individually assess the commission income history to determine the appropriate calculation method.
- Refer to Significant Increase or Decrease in Variable Income in this section for additional information.

Sole Proprietorship

A sole proprietorship is an unincorporated business owned by an individual. The individual owner has unlimited personal liability for all debts of the business. Since no distinction is made between the owner's personal assets and the assets used in the business, creditors may take either (or both) to satisfy business obligations.

- Business income or loss is reported on Schedule C of the borrowers 1040's.
- Signed and dated IRS Form 1040 (individual) with all schedules for the most recent 2 years – or as required by the AUS.
- If a tax return for the most recent fiscal year is not included due to preparation constraints, a 12-month profit and loss statement for that period is required.
- A balance sheet or year-to-date profit & loss statement is generally not required; it is only necessary to obtain if needed to determine the continuance or stability of the borrower's income.
- An IRS Form 4506-T signed and dated at application and closing.
- IRS Transcripts dated prior to the closing date.

Note: For AUS-underwritten loans, income documentation is, in most cases, determined by the conditions of the AUS decision. However, when there is probability of instability or declining earnings for the borrower, the borrower's company or the borrower's line of work, additional income documentation is warranted.

Corporation

A corporation is a state-chartered business entity that is owned by stockholders. The corporation, not the stockholder, is liable for the business debts and losses and the stockholder's personal liability is limited to the amount they have invested in the corporation.

The corporation files a Form 1120 to report income or losses. A stockholder, if employed by the corporation will receive a W-2 to report income. A stockholder may also receive dividend income. IRS Form 1040 (individual) signed and dated with all schedules **AND**:

- IRS Form 1120 (Corporation), signed and dated with all schedules.
- An IRS Form 4506-T completed and signed at application and closing.
- IRS Transcripts dated prior to the closing date.
- 2 years most recent signed and dated tax returns (IRS Forms 1040 and 1120).
- If a tax return for the most recent fiscal year is not included due to preparation constraints, a 12-month profit and loss statement for that period is required.
- A balance sheet or year-to-date profit & loss statement is generally not required, but may be necessary to obtain if needed to determine the continuance or stability of the borrower's income.

- Business tax returns may be waived if the borrower meets all of the following requirements:
 - Self-employed in the same business for at least 5 years.
 - Borrower's individual returns show an increase in self employment income over the last 2 years.
 - Borrower is paying the down payment and closing costs from own funds, and not from the business account.

Calculating Corporate Income

Before adding after-tax corporate earnings to borrowers' income for qualification purposes, the borrowers' percentage of ownership and right to the funds must be verified. IRS Form 1120 (U.S. Corporation Income Tax Returns) and the Self-Employed Income Analysis or Plaza's Income Worksheets are used for this purpose.

Percentage of Ownership

The borrowers' percentage of ownership in the corporation is usually found in the "compensation of officers" section of the corporate tax returns. If this information is not provided on the tax return, a letter from a corporation's accountant or other evidence of the borrowers' ownership must be obtained.

Share in Corporate Profits

The borrowers' portion of the corporation's after tax profits can be used for qualification only if the borrower owns 100% of the corporation. If the corporation operates on a fiscal year other than a calendar year, make the necessary adjustments to relate the corporate income to the 1040's which are on a calendar year basis.

Fiscal versus Calendar Year

If the corporation operates on a fiscal year that is different from the January through December calendar year, adjustments must be made to relate the corporate income to the borrowers' individual tax return. This information is reflected directly under the title "U.S. Corporation Income Tax Return" on the Form 1120.

Analyzing Corporate Returns

When reviewing IRS Form 1120 to determine the adjusted business income, underwriters should pay particular attention to the following items:

Taxable Income (corporations net profit) which must be reduced by the corporations total taxes to determine the after tax income.

Depreciation which must be added back to the corporations after tax income.

Depletion which must be added back to the corporations after tax income.

Once the adjusted business income has been determined, the following calculation should be done to determine the total income available to the borrowers for qualifying purposes:

Adjusted business income PLUS.
Borrowers' percentage of ownership MINUS.
Dividend Income reported on borrowers' individual return.

Note: For AUS-underwritten loans, income documentation is, in most cases, determined by the conditions of the AUS decision. However, when there is probability of instability or declining earnings for the borrower, the borrower's company, or the borrower's line of work, additional income documentation is warranted.

S-Corporation

S Corporation is a state chartered business, which is generally smaller than a Corporation, and limited to 35 stockholders. The S corporation, not the stockholders, is liable for the business debts and losses. The S corporation will file a Schedule K-1 with the Form 1120S. IRS Form 1040 (individual) signed and dated with all schedules and IRS Form 1120S (S Corporation), signed and dated with all schedules and:

- 2 years most recent signed and dated tax returns (1040 and 1120S) **AND**
- 2 years most recent W-2's from the S Corporation.
- If a tax return for the most recent fiscal year is not included due to preparation constraints, a 12-month profit and loss statement for that period is required.
- A balance sheet or year-to-date profit & loss statement is generally not required, but may be necessary to obtain if needed to determine the continuance or stability of the borrower's income.
- Business tax returns may be waived if the borrower meets all of the following requirements and AUS does not require:
 - Self-employed in the same business for at least 5 years.
 - Borrower's individual returns show an increase in self-employment income over the last 2 years.
 - Borrower is paying the down payment and closing costs from own funds, and not from the business account.

Note: For AUS-underwritten loans, income documentation is, in most cases, determined by the conditions of the AUS decision. However, when there is probability of instability or declining earnings for the borrower, the borrower's company, or the borrower's line of work, additional income documentation is warranted.

General and Limited Partnership

A partnership is formed when 2 or more individuals establish a business and share profits, losses, and responsibility for running the business. Each partner agrees to act in accordance with the partnership agreement.

In a general partnership, each partner is personally liable for the debts of the entire business and is responsible for the actions for every other partner. A general partnership is dissolved immediately upon the death, withdrawal, or insolvency of any of

the partners, although the personal liability to partnership creditors exists even after the partnership is dissolved.

In a limited partnership, the limited partners have no right to participate in the management and operation of the business. The limited partner's liability is limited to the amount invested in the partnership. A limited partner's death, withdrawal or insolvency does not dissolve the partnership.

Partnerships file a 1065 tax return with the IRS for information purposes. Income from the partnership flows to the individual partner's tax returns, and is reported on a Schedule K-1. The partners pay taxes on their proportionate share of net partnership income.

For qualification purposes the following requirements and documentation should be provided:

- IRS Form 1040 (individual) signed and dated with all schedules **AND**
- IRS Form 1065 (Partnership) signed and dated with all schedules and
- Signed and dated Partners Share of Income (K-1).
- An IRS Form 4506-T completed and signed at application and at closing.
- IRS Transcripts dated prior to the closing date.
- 2 years most recent signed and dated tax returns (1040 and K-1) **AND**
- 2 years most recent signed and dated K-1s and W-2's.
- If a tax return for the most recent fiscal year is not included due to preparation constraints, a 12-month profit and loss statement for that period is required.
- Exceptions:
 - W-2's are not required.
 - A balance sheet or year-to-date profit & loss statement is generally not required, but may be necessary to obtain if needed to determine the continuance or stability of the borrower's income.
 - Partnership tax returns may be waived if the borrower meets all of the following requirements:
 - Self-employed in the same business for at least 5 years.
 - Borrower's individual returns show an increase in self-employment income over the last 2 years.
 - Borrower is paying the down payment and closing costs from own funds, and not from the business account.

Note: For AUS-underwritten loans, income documentation is, in most cases, determined by the conditions of the AUS decision. However, when there is probability of instability or declining earnings for the borrower, the borrower's company or the borrower's line of work, additional income documentation is warranted.

**Calculating
Allowable
Income from**

In order to use income from an S corporation or partnership to qualify self-employed borrowers for a loan, Underwriters must verify that the borrowers have access to the funds. This information is transferred from the business' federal tax returns to Schedule

S Corp and Partnerships

E of the borrowers' IRS Form 1040.

The Fannie Mae Self-Employed Income Analysis form or Plaza's Income Worksheet should be used to determine the borrowers' allowable share of the adjusted business income.

If the borrowers have provided evidence that they have access to a share of the business' adjusted business income, the following calculation should be done to determine the total income available to the borrowers for qualifying purposes.

Note: For AUS-underwritten loans, income documentation is, in most cases, determined by the conditions of the AUS decision. However, when there is probability of instability or declining earnings for the borrower, the borrower's company, or the borrower's line of work, additional income documentation is warranted.

Analyzing Self-Employment

Self Employed income should be analyzed by using either the Schedule Analysis Method or the Adjusted Gross Income approach. Whichever form is used must be included in the loan package to show how the income was calculated.

An average monthly income must be developed using at least 2 full years of the applicant's tax returns. When a year-to-date profit and loss statement is used, the income must be consistent with previous year's earnings. If the applicant has provided 3 years tax returns, income for all 3 years may be used to establish an average income. Because self-employed income may change each year, an average better approximates the applicant's long-term earnings ability. Projected income is not acceptable for qualifying purposes.

The financial statements and tax returns, for the self-employed applicant's business, must be reviewed to confirm that the business will continue to generate the income the applicant needs to qualify for the requested mortgage.

If the applicant's individual tax returns confirm sufficient income and the business tax returns and financial statements indicate that it is a viable company, it is not necessary to investigate the business any further.

A continuing decline in income over 2 or 3 years would be a reason to carefully consider and possibly decline the application, even if the applicant's current income and debt ratios meet established guidelines.

Evaluation of the self-employed applicant's individual tax returns will vary depending on which of the income analysis methods are used.

Schedule Analysis Method of Evaluating

The documentation required for self-employed borrowers is determined by the business type and loan program requirements as outlined in the following table. If the business was audited, include copies of the audited statements.

Tax Returns	IRS Form	Analysis Performed
	Schedule C (Profit or Loss from Business)	Used to determine the business income for sole proprietorship. Depletion and depreciation should be added and the 50% meals and entertainment exclusion should be deducted from the net income or loss to determine actual income.
	Schedule D (Capital Gains and Losses)	<p>A capital gain or loss is the result of an individual selling an investment asset (stocks, bonds, real estate, etc.) at a price higher or lower than the amount originally purchased.</p> <p>Capital gains that are non-recurring may not be considered in determining income. Only recurring gains consistent over a period of time may be considered in the income analysis. Borrower must have sufficient remaining like assets with income likely to continue for the next 3 years.</p> <p>The underwriter must review and average 2 years' signed tax returns when determining income. In addition, the underwriter should determine if the asset sold will have an adverse affect on future income. Capital losses reflect a reduction of personal assets and should not be considered when determining qualifying income.</p>
	Schedule E (Supplemental Income or Losses)	<p>Income or loss is taken from Schedule K-1 of the US Partnership Return (IRS Form 1065).</p> <p>If the business is a partnership, the income or loss is the sum of ordinary income (or loss) and the guaranteed payments.</p> <p>If the business is an S Corporation, the income or loss is the sum of ordinary income (or loss) and other income (or loss).</p>
	Schedule F (Farm Income and Expenses)	Used to determine business income from farming. To determine available income, depreciation may be added back to the net profit or loss. Schedule F income on the subject property may indicate the property is ineligible as a working farm.
	Form 2106 (Employee business Expenses)	Used when a borrower has business expenses required in the performance of their employment. Business expenses actually paid by the borrowers should be deducted from the available income.
	W-2 (Wages and Tax statement)	Used to verify income of a borrower receiving wages from a Corporation or S Corporation, when he or she is an officer of the corporation.
	IRS Transcripts	Used to validate information on tax returns, W-2 (Wage and Tax Statements), YTD Pay Stubs and written VOE's.

Adjusted Gross Income Method

Non-cash items (such as depreciation and amortization), casualty losses, and loss carryovers from previous tax years can be added back to the adjusted gross income when determining qualifying income.

Description:

The adjusted gross income method for determining self employment earnings uses the "adjusted gross income" (AGI) reported by borrowers on their signed individual tax

T returns. This amount is increased or decreased based on a line by line analysis of the borrowers' IRS Form 1040 (U.S. Income Tax Return).

When using the adjusted gross income method, the following information is reviewed:

Form	Line	Analysis Performed
Form 1040	Wages, Salaries, or Tips	Self employed borrowers who report wages, salaries, or tips often operate as a corporation and pay themselves a salary. These borrowers should be analyzed based on the corporate tax returns. If the income reported is due to a spouse's employment, and the spouse is a party to the subject loan, the spouse's income should be subtracted from the AGI and the spouse's income must be verified with the employer following standard verification procedures.
Schedule B	Taxable Interest Income	May be used only if it has been received for the past 2 years and the interest bearing asset will not be used as a source of funds for the down payment or closing costs.
Schedule B	Tax-Exempt Interest Income	May be used only if it has been received for the past 2 years and is expected to continue. If usable, this amount is added back to the AGI. Only the portion not being used for the down payment or closing costs may be used.
Schedule B	Dividend Income	May be used only if it has been received for the past 2 years and the dividend producing asset will not be used as a source of funds for the down payment or closing costs.
Form 1040	Taxable Refunds of state and local income taxes	This income is non-recurring and must be deducted from the AGI.
Form 1040	Alimony Received	May be used if it will continue for the next 3 years and has been received for at least 1 year from the date of the loan application.
Schedule C	Business Income or Loss	Represents the business income or loss for a sole proprietorship. To arrive at the net income available, the depletion and depreciation should be added back, and the 50% meals and entertainment exclusion should be deducted from the AGI.
Schedule D	Capital Gains or Losses	A non-recurring gain may not be considered. However, if the income has a constant turnover of assets that produces regular gains, it may be considered. Borrower must have sufficient like remaining assets with income likely to continue for the next 3 years. The underwriter must review and average 2 years' signed tax returns when determining income. Capital losses reflect a reduction of personal assets and should not be considered when determining qualifying income.
Form 1040	IRA Distributions	May be used if it will continue for the next 3 years. The non-taxable portion may be added back to the AGI.

Form 1040	Pensions and Annuities	May be used if it will continue for the next 3 years. The non-taxable portion may be added back to the AGI.
Schedule E	Rents, Royalties, partnerships, Estates and Trusts	Depreciation or loss from rentals and royalties may be added back to the AGI. Income/Loss from Partnerships and S Corporations may be included. Income from estates and trusts may be included, provided there is a documented evidence of the amount, frequency of receipt, and continuity for the past 3 years.
Form 8582	Un-allowed Losses or Un-allowed Loss Carryovers	Un-allowed losses should be deducted from the AGI, and the un-allowed loss carryovers should be added to the AGI.
Schedule F	Farm Income or Loss	Indicates profit or loss from farming. Any depreciation may be added back to the AGI.
Form 1040	Unemployment income	May be used if there is documented proof that it has been regularly received for 2 years, especially if the unemployment supplements seasonal work. If the income is not adequately documented it must be deducted from the AGI.
Form 1040	Social Security Benefits	May be used if it will continue for the next 3 years. The non-taxable portion must be added back to the AGI.
Form 1040	Adjustments to Income	Most income adjustments on Form 1040, except reimbursed employee business expenses, may be added back to the AGI, including: IRA deductions Self-employed health insurance deduction KEOGH retirement plans Penalties on early withdrawals of savings Alimony paid, which must also be included in the monthly debt
Form 2106	Employee Business Expenses	These are actual out of pocket expenses and should be deducted from the AGI.
Form 4562	Depreciation and Amortization	Amortization may be added back to the AGI. Depreciation should not be added back as it has already been considered where necessary, on a schedule by schedule basis (Schedule E).
IRS Transcripts	N/A	Used to validate information on tax returns, W-2 (Wage and Tax Statements), YTD Pay Stubs and written VOE's.

Calculating Un-allowed Losses and Carryovers

The Adjusted Gross Income (AGI) must be adjusted for any un-allowed loss or carryover amount. When using the Adjusted Gross Income method to calculate earnings for self-employed borrowers, underwriters should always review income from rents, royalties, partnerships, estates, trusts, etc. (as reported on Schedule E) for un-allowed losses or un-allowed loss carryovers.

The figures necessary to calculate un-allowed losses and carryovers are reported on IRS Form 8582, Passive Activity Loss Limitations.

Treating all numbers as positive figures, un-allowed losses and un-allowed loss carryovers are calculated as follows:

$$\begin{array}{rclcl} \text{Net loss for} & + & \text{Net loss for} & - & \text{Total losses allowed for} & = & \text{Un-allowed losses or} \\ \text{rental real estate} & & \text{passive} & & \text{all passive activities} & & \text{un-allowed loss} \\ \text{activities} & & \text{activities} & & \text{during tax year} & & \text{carryover} \end{array}$$

If total net losses are greater than the allowed losses, the un-allowed loss amount must be deducted from the AGI. If the net losses are less than the allowed losses, the un-allowed loss carryover should be added to the AGI.

Rental Income

Rental income may be used in qualifying the borrower. The documentation that is used to support the borrower's continued receipt of rental income and the calculation of such income depends on whether the rental income is received in connection with the subject property for the mortgage being underwritten or in connection with other properties the borrower owns.

The housing expense for the rental property (PITIA) is factored into the amount of the net rental income (or loss); therefore, it should not be counted as a monthly obligation.

Reasonable adjustments to gross rental income must be made to compensate for vacancies, operating and maintenance expenses.

Rental Income is from:			
Topic	Subject property: 2-4 unit Primary Residence	Subject Property: 1-4 unit Investment	Not Subject Property: 2-4 unit Primary and 1-4 unit Investment
Rental Income used as stable Monthly income for Qualifying Purposes	If used, rental income must be substantiated with: <ul style="list-style-type: none"> • The borrowers prior year federal tax return if the property has been owned for at least 1 year, in the case of a refinance, OR appraisal form 1025 (NOTE: if SFR Investment 1007 is required), AND • Copies of the present lease(s), if applicable 		Use the following to document income: <ul style="list-style-type: none"> • Complete 1040's with all schedules for the most recent year if borrower has owned the property for at least 1 year, OR • Verified net rental

	<p>Note: Positive net rental income from Schedule E of the borrower's tax returns or positive Net Cash Flow may be considered stable monthly income.</p> <p>Negative net rental income from Schedule E or negative Net Cash must be considered a liability for qualification purposes.</p>	<p>income from signed lease(s) if the borrower has owned the property for <1 year and the income is not reported on the individual tax returns.</p> <p>Note: Aggregate net rental income may be counted as stable monthly income, provided the reliability of receipt is clearly supported by the documentation in the file.</p> <p>Aggregate negative net rental loss from Investment Properties and 2-4 unit Primary Residences must be considered a liability for qualification purposes.</p>
1040's (Most recent year)	<p>If borrower owned rental property during the previous tax year(s), provide complete federal income tax returns including Schedule E, for tax years required either by AUS or program summary to properly determine the net rental income/loss for qualifying purposes.</p> <p>A borrower may occasionally claim amortization, casualty losses, or a one-time extraordinary expense, such as a new roof. When reported in Schedule E for these type of expense, add it back to Total Income. Expense must be properly documented and explained.</p>	
Appraisal	The income approach on the appraisal must substantiate the rental income used for qualifying.	N/A
Signed Lease(s)	<p>Leases, by themselves, may not be used for documenting stable monthly income for qualifying purposes; however, they may be used as support for the rental income used to qualify.</p> <p>Note: If the borrowers did not own the property during the previous tax year, then the lease can be used to evaluate rental income. If leases are used, 75% of the gross rental income shown on the lease</p>	<p>May be used to document stable monthly income if the borrower did not own the property in the previous tax year.</p> <p>Note: If leases are used, 75% of the gross rental income shown on the lease may be used to offset the mortgage and</p>

	may be used to offset the mortgage and other expenses for the property to determine net rental income or loss.		other expenses for the property to determine net rental income or loss.
Reserves *	Follow the AUS when the subject property is the borrower's primary residence.	<p>When the borrower has 1-4 Financed Properties: 2mo for subject property and 2 months PITIA for each other financed 2nd home or 1-4 investment property the borrower owns and/or is obligated on.</p> <p>When the borrower has 5-10 Financed Properties: 6months PITIA for each other financed 2nd home or 1-4 investment property the borrower owns and/or is obligated on.</p>	Follow the AUS
Experience Managing Investment Properties	There is no minimum landlord experience required.	<p>DU Loans Only: There is no minimum landlord experience required.</p> <p>LP Loans Only: Demonstrate at least a 2-year history of managing 1-4 unit Investment Properties if using rental income to qualify or to offset the mortgage.</p>	There is no minimum landlord experience required.

* Refer to Plaza's Retained Property/Primary Residence Conversation within [Eligible Transactions](#) Guidelines for specific reserve requirements when the borrower is retaining their current residence.

**Primary
Residence
Conversion
to Investment
Property with
30% or
greater
Equity**

If the current primary residence is converting to an investment property upon purchase of a new primary residence and equity is equal to or greater than 30% , use the following to qualify:

- The 30% equity must be documented using, at minimum, a 2055 Exterior-Only Inspection Residential Appraisal Report is required. 75% of the gross rental income may be used to offset the mortgage payments for qualifying purposes
- Standard reserve requirements apply

The rental income from the conversion of the primary residence must be documented with the following:

- Copy of the fully executed lease agreement
- The receipt of a security deposit from the tenant(s) and documentation of deposit into the borrower's account.

**Primary
Residence
Conversion
to Investment
Property with
less than 30%
Equity**

If the current primary residence is converting to an investment property upon purchase of a new primary residence and 30% equity cannot be documented use the following to qualify:

- Rental income cannot be used to offset the mortgage payment
- Both the current mortgage payment and the proposed mortgage payment must be used to qualify the borrower for the new transaction
- Reserves of 6 months PITIA for both properties are required.
- The rental income from the conversion of the primary residence must be documented with the following:
 - Copy of the fully executed lease agreement
 - The receipt of a security deposit from the tenant(s) and documentation of deposit into the borrower's account.

For example, if the current PITIA payment is \$1,000, input a negative net rental income of \$1,000. If the current primary residence is converting to an investment property upon purchase of a new primary residence, refer to [Proposed Rental Income guidelines](#) in this chapter.

**Primary
Residence
Conversions
(Retained
Residence) to
Second
Homes or a
Pending Sale**

If the current residence is converting to a second home upon the purchase of a new principal residence or pending sale, but will not close prior to the new transaction (for instance, title transfer to the new owner) qualify the borrower(s) using the following:

- Both the current and proposed mortgage payments.
- Underwriters must ensure the AUS is using both the current and proposed mortgage loan payment amounts with calculating the total expense ratio.
- Mortgages associated with the current residence should not be marked "Paid at Close" or "Omit" in the liabilities section of the online loan application.
- 6 months PITIA reserves for both properties are required (or as determined by AUS).

If there is documented equity of at least 30% in the existing property, reduced reserves of 2 months PITIA for both properties is required.

- The 30% equity in the existing property must be documented using, at minimum, a 2055 Exterior-Only Inspection Residential Appraisal Report is required.

For pending sales on existing properties, provide the following documentation to qualify without the existing property PITIA payment all the following must be evidenced in the loan file.

- The executed sales contract for the current primary residence
- Confirmation that any financing contingencies have been cleared
- Evidence of PITIA reserves as outlined above

**Business
Loss from a
Non-
Borrowing
Spouse**

All negative net income from a non-purchasing spouse must be taken into consideration for borrower qualification.

**Non-
Reimbursed
Business
Expenses**

When a borrower has non-reimbursed business expenses, such as classroom supplies, uniforms, meals, gasoline, automobile insurance, and/or automobile taxes, determine the recurring monthly debt obligation for such expenses by developing an average of the expenses. Review the Schedule A and/or IRS Form 2106 from 1 of the following for the number of years required:

- Personal income tax returns including all schedules
- Tax transcripts

When calculating the total debt-to-income ratio, the average for non-reimbursed expenses must be subtracted from the borrower's stable monthly income.

- **See the [Plaza Income Worksheet](#) for treatment of these business expenses.**

**Projected or
Proposed
Income**

Projected or proposed income may not be used as part of qualification income, unless the borrower will be employed prior to the loan closing and all of the following requirements are met:

- A legally binding employee contract must be provided. Offer letters are not acceptable. The borrower must have started employment at the new position as per the terms of the employee contract.

- VOE is required if the borrower has not yet received a paystub.
- Verification borrower has started employment must be done prior to loan closing.

**Temporary
Income**

Temporary employment may be considered when the borrower works through an agency (or agencies) and has demonstrated this to be a stable form of income. The borrower's work history must be verified for 2 years and the borrower must have worked steadily as a temporary employee for a minimum of 18 months.

- Income will be averaged over the 2-year period, but not less than 18 months.
- Obtain W-2's for the most recent 2 years plus a current paystub documenting at least 30 days of income.

No consideration will be given to temporary income of a borrower who is not employed through a temporary agency and whose sole employer states the borrower's employment is temporary.

**Manufacturing
Piece Work**

An employee may be paid based upon the number of units completed within a given time. If the borrower has been employed in this line of work (and method of computing income) for at least 2 years, the income may be used for qualifying. Obtain the following to document:

- Most recent year-to-date paystub covering 30 days income.
- W-2's for the most recent 2 years.

**Irregular
Income/
Uncommon
Income
Structures**

There may be situations where normal calculations will not apply to the income the borrower receives. Some employment fields, such as health care professionals, do not work a 40-hour workweek, but continue to be paid overtime or other fluctuating income.

Calculating the income for such employment may require a Written Verification of Employment (WVOE), in addition to a paystub and W-2's, to provide an explanation of earnings pattern.

Credit should not be given for both a 40-hour workweek and overtime, in such cases. It may be that an average of the borrower's total income would give a more accurate picture of the borrower's earnings.

The overall strength of the borrower, the stability of income and the likelihood of the continuance of the income must be considered when using variable forms of income.

**Significant
Increase or
Decrease in
Variable
Income**

An underwriter must review any file when variable income is used to qualify with a significant increase or decrease in variable income (bonus, commissions, overtime, etc.). The calculation method used should be the most appropriate and not the one that yields the highest amount. Trends in the borrower's industry should also be considered in the evaluation of stability of income.

Significant Decrease in Income

- When the borrower has experienced a significant decrease in income, the income cannot be averaged using a previous higher level unless there is documentation of a one-time occurrence (e.g., injury) that prevented the borrower from working or earning full income for a period of time and proof that the borrower is back to the income amount that they previously earned.
- The underwriter must focus the analysis on the most recent earnings and the income that is most likely to be received at the level used for qualifying.
- The loan file must contain the reason for the significant decline in variable income from the borrower.
- When the borrower attributes the significant decrease in income to a one-time occurrence (e.g. injury, leave of absence to care for ill family member, etc.) that prevented the borrower from working or earning full income for a period of time, the variable income can be averaged using a previous higher level if there is proof that the borrower's income is back to the level they previously earned.
- When the significant decrease in income is not attributed to a one-time event, an underwriter must focus the analysis on the most recent earnings and the income that is most likely to continue.
- The loan file must contain the underwriting rationale for the inclusion of such income.

Significant Increase in income

When the borrower has experienced a significant increase in income, the higher income may not be used to qualify the borrower, unless there is sufficient documentation to determine that the increase is stable and likely to continue at the level used for qualifying (e.g. that the income is not a one-time incentive payment).

- The loan file must contain the reason for the significant increase from the borrower.

Example: The underwriter must verify the income is not a one-time incentive payment that is contributing to the increase in income. If it is a one-time incentive payment, the increased amount is not considered stable and likely to continue.

While fluctuations in income, particularly from variable sources such as bonus, overtime or commissions are expected, if there is a significant increase or decrease in income, the loan file must contain a reason for the increase or decrease along with supporting rationale for the inclusion of such income.

**Change of
Employer in
Prior 2 Years**

If the borrower has changed jobs within the last 2 years, the loan file must contain documentation showing a history of receipt of bonus income over the prior 2 years.

Documentation must include verification from all current and prior employers providing bonus income from the past 2 years. If the borrower has yet to receive any bonus income from the new employer, the loan file must also contain an employment contract or other documentation from the employer that specifies the amount and terms of the borrower's incentive or variable compensation in order to consider the bonus income for qualification.

**Other Income
Sources**

Other sources of income are described in detail below. If used to qualify the borrower, document a history of regular receipt and the probability of continuance for at least 3 years.

- Alimony, Child Support and Maintenance Payments
- Auto Allowances and Expense Account Payments
- Capital Gains and Losses
- Disability
- Social Security
- Spousal or Child Support
- Employment by a Relative, Property Seller or Real Estate Broker
- Foreign Income
- Foster Care Income
- Housing or Parsonage Allowance
- Interest and Dividend Income
- Military Income
- Shift Differential
- Tip and Gratuity Income
- Non-taxable Income
- Note Income
- Public Assistance
- Retirement, Pension, Annuity, and IRA Distributions
- Annuities
- Royalty Payments
- Seasonal Part-time and Seasonal Second Job Income
- Social Security Income
- Teachers
- Trust Income
- Workers Compensation
- Unemployment Benefits Income
- Union Members
- VA Benefits

**Alimony,
Child Support
and
Maintenance
Payments**

Alimony, child support, and maintenance income will be considered when based on a divorce decree; court ordered separation agreement, (subject to state specific restrictions), court decree, or another legal agreement provided the payment terms confirm that the income will continue for at least 3 years.

If the age of the child is not clearly defined, additional confirmation must be obtained to document the age of the child and income continuance.

When determining the acceptability of this income, the borrower's regular receipt of the full payment due and any limitations on the continuance of the alimony (duration over which the alimony is required to be paid) must be taken into consideration).

If a borrower who is separated does not have a court order that specifies alimony, proposed or voluntary payments should not be considered as stable income.

Income may be considered stable with documentation evidencing that the borrower has been receiving full, regular, and timely payments for the past twelve months.

If the borrower has been receiving full, regular, and timely payments for 6 to twelve months, the income may be used for qualification, as long as it does not represent more than 30 percent of the total gross income.

Income may not be considered stable when a borrower has been receiving full, regular, and timely payments for less than 6 months or has been receiving full or partial payments on an inconsistent or sporadic basis. This income may be used as a compensating factor only.

One of the following types of income documentation is required:

- A copy of a written legal agreement or court decree describing the payment terms for the child support, the amount of the award and the period of time over which it will be received.
- Any applicable state law that mandates child support documents, which must specify the conditions under which payments must be made.
- In addition, 1 of the following is required to document regular receipt of the full payment based on the number of months the income is being used to qualify as described above:
 - Desktop Underwriter (DU) and Loan Prospector Loans: Follow automated underwriting documentation requirements.

**Auto
Allowances &
Expense
Account
Payments**

Automobile allowances will be considered stable income for a borrower who has been receiving the income for the past 2 years, provided all associated business expenditures are included in the calculation of the borrower's total Debt-to-Income Ratio.

Either an actual cash flow approach or an income and debt approach may be used to calculate the income.

When the borrower files an IRS Form 2106, the actual cash flow approach should be used. Any funds in excess of the borrower's monthly expenses are added to the borrower's monthly income.

Any expenses in excess of the monthly allowance must be included in the borrower's total monthly obligations.

When the borrower uses IRS Form 2106 and recognized "actual expenses" instead of the standard mileage rate, look at the actual expenses section to identify the borrower's actual lease payments, and then make the appropriate adjustments.

If a borrower elected to use a standard mileage deduction instead of taking the actual cash expenditure for auto expenses when he or she completed their personal tax return, an add-back can be used for qualification purposes. The applicable add-backs are as follows:

Tax Year	Add-Back per Mile
2009	\$0.21
2010	\$0.23
2011	\$0.23
2012	\$0.23

When the borrower does not report the allowance on IRS Form 2106, the income and debt approach should be used. The full amount of the allowance is added to the borrower's monthly income. The full amount of the lease or financing expenditure for the automobile must be added to the borrower's total monthly obligations.

**Capital Gains
& Losses**

A capital gain or loss is generally a one-time transaction; and, therefore, should not be considered as either a gain or loss in determining income. However, if the borrower has a constant turnover of assets that produces regular gains and losses, the capital gain or loss may be considered (e.g., a person who buys old automobiles, restores them, and sells them for profit).

If the borrower has operated in this manner over a sustained period, an average of gains or losses may be developed, as long as the borrower provides evidence that he or she owns additional property or assets that can be sold if extra income is needed to make future mortgage payments.

Personal tax returns must be reviewed to get an accurate picture of the average earnings from this source. For example, an asset sold during the year might be an income-generating asset, resulting in a reduction in future income after the sale.

All of the following income documentation is required:

- A minimum of the most recent 2 years personal tax returns with all schedules. In some cases, additional year's tax returns may be required.
- Evidence of ownership of additional property or assets.

Disability

Long Term Disability

- Long-term disability income (e.g., Social Security disability benefits, VA disability compensation, worker's compensation, private disability insurance) may be considered qualifying income that has a reasonable expectation of continuance unless there is a pre-determined insurance and/or benefit expiration date that is less than 3 years (e.g., stated termination of a private disability insurance policy).
- Pending or current re-evaluation of medical eligibility for insurance and/or benefit payments is not considered an indication that the insurance and/or benefit payment will not continue.
- Evidence of the source, amount, insurance and/or benefit type, and consistent receipt for the most recent 2 months must be obtained.
- Borrower receives Social Security disability benefits, the award letter only needs to indicate the benefit amount; verification of continuance is not required.
- Note: such documentation as a letter from the borrower's doctor, letter addressing extent of disability, social security award 1099(s) or tax returns to support SSDI should not be requested) Identifying the condition/disability is not required and under no circumstance should the borrower or anyone associated with the borrower, be asked to provide.

Temporary Disability

- Temporary leave/Short Term Disability from an employer may encompass various circumstances (e.g., family and medical, short-term disability, maternity, other temporary leaves with or without pay).
- Temporary leave is generally short in duration. The period of time that a borrower is on temporary leave may be determined by various factors such as applicable law, employer policies and short-term insurance policy and/or benefit terms. Leave ceases being considered temporary when the borrower does not intend to return to the current employer or does not have a commitment from the current employer to return to employment.
- A loan should not be denied specifically because a borrower is on temporary leave or short-term disability.
- Determining qualifying income and borrower's capacity to meet obligations while on temporary leave.
- Borrowers returning to their current employer prior to the first mortgage payment due date:
 - Qualifying income from the borrower's gross monthly income amount that will be received upon the borrower's return to current employer may be used.

**Documentation Requirements for Temporary Leave/Short Term Disability:
Returning to work Prior to First Mortgage Payment Due Date.**

- Documentation from current employer confirming the following:
- Borrower's statutory right to return to work (or the employer's commitment to permit the borrower to return to work) **AND**
- Borrower's confirmed date of return, **AND**
- Borrower's post-leave employment and income **AND**
- Written statement signed by the borrower confirming that the borrower will return to current employer and stating the confirmed date of return that has been agreed upon between the borrower and the employer.
- Borrowers returning to their current employer after the first mortgage payment due date:
 - Qualifying income used must be the lesser of the qualifying income amount that will be received upon the borrower's return to their current employer or the borrower's gross monthly income being received for the duration of the temporary leave. In the event that the income has been reduced or interrupted, available liquid assets may be used as a partial. **OR**
 - Complete income supplement up to the amount of the income reduction. Assets that are required for the transaction (e.g., down payment, closing costs, financing costs, prepaids/escrows and reserves) may not be considered as available assets.
- The following documentation is required for borrowers returning to their current employer after the first mortgage payment due date:
 - Documentation evidencing amount, duration, and consistency of all temporary leave income sources being used to qualify the borrower (e.g., short-term disability benefits or insurance, sick leave benefits, temporarily reduced income from employer) that are being received during the temporary leave, **AND**
 - Borrower's statutory right to return to work (or the employer's commitment to permit the borrower to return to work) **AND**
 - Borrower's confirmed date of return, **AND**
 - Borrower's post-leave employment and income **AND**
 - Written statement signed by the borrower confirming that the borrower will return to current employer and stating the confirmed date of return that has been agreed upon between the borrower and the employer, **AND**
 - Documentation evidencing amount, duration, and consistency of all temporary leave income sources being used to qualify the borrower (e.g., short-term disability benefits or insurance, sick leave benefits, temporarily reduced income from employer) that are being received during the temporary leave **AND**
- All available liquid assets used to supplement the reduced income for the duration of the temporary leave must be in addition to cash reserves required by specific program, be in liquid form available for use and be verified, **AND**
- Written rationale explaining the analysis used to determine the qualifying income.

**Social
Security**

Social Security Supplemental Security Income (SSI) may be considered as qualifying income that has a reasonable expectation of continuance unless there is evidence that the benefits will not continue. Pending or current re-evaluation of medical eligibility for benefit payments is not considered an indication that the insurance and/or benefit payment will not continue. Evidence of the source, amount, benefit type, and consistent receipt for the most recent 2 months must be obtained. Acceptable documentation may be any of the following:

- A copy of the Social Security Administration's award letter.
- Copies of the borrower's previous 12 months bank statements to confirm regular deposit of the payment.
- Signed tax returns for the most recent 2 years, **AND**
- A signed IRS form 4506-T or 1099 forms are also acceptable.

Social Security Benefits include any of the following types of payments

- Social Security Retirement Benefits
- Supplemental Security Income
- Survivor's Benefits (surviving spouse or child payments)

**Spousal or
Child Support**

Spousal or child support must continue at least 3 years after the date of the original mortgage loan application to be considered.

Acceptable verification of this income may be 1 of the following documents:

- Divorce Decree
- Formal Separation Agreement
- Court Order for support.
- Any other type of legal agreement or court decree that describes the payment terms.
- A copy of any applicable state law that requires alimony, child support or maintenance payments and specifies the conditions under which the payments must be made.
- The document must specify the amount of the award and the period of time over which it will be received.
- The borrowers must provide evidence that the funds have been received for the last 12 months. Acceptable evidence of receipt is as follows:
 - Deposit slips
 - Cancelled checks
 - Bank statements
 - Federal Income tax returns
- A 6 to 12-month documented history of receipt of income is acceptable providing the income does not exceed 30% of the total gross qualifying Income.

Conforming loans may provide a 3 month documented history of receipt of income, but only if the AUS certificate provides an Accept recommendation.

**Employee
Identity of
Interest**

**Employment by a Relative, Domestic Partner, Fiancé/ Fiancée, or Family Business
Property Seller or Real Estate Broker**

A borrower employed by a family member or employed by a family-held business, property seller or real estate broker is eligible. Full documentation is required. (See [Plaza's Transaction Chapter](#) for additional information regarding identity of interest transactions)

If employed by a relative, the business accountant must verify that the borrower is not self-employed by indicating his or her percentage of interest in the business. The accountant must be a disinterested third party.

All of the following income documentation is required:

- Most recent paystub documenting 30 days of income.
- W-2's covering the most recent 2 years.
- Complete signed individual federal tax returns for the most recent 2 years **OR**
- Written VOE covering the most recent 2 years.
- Complete signed individual federal tax returns for the most recent 2 years.
- If the borrower is newly hired, previous employment in the same or related field must be verified.

**Foreign
Income**

Standard documentation is required when foreign income is used to qualify. Reduced documentation is not allowed regardless of AUS. Automated Underwriting Systems cannot detect foreign income; therefore it is the Underwriter's responsibility to require standard documentation when foreign income is used to qualify.

When the borrower is a U.S. citizen or permanent resident alien employed in the United States by a foreign corporation, the income used to qualify must be documented with the following:

- Most recent 2 years signed federal tax returns.
- Most recent year-to-date paystub covering at least 30 days of income.
- 2 years W-2's.
- The earnings must be in U.S. dollars (or converted to U.S. dollars) and the employer must confirm that the income is protected from any exchange rate fluctuations.
- Employed abroad by a U.S. company or a foreign company, the personal tax returns filed with the IRS will be required to indicate the income earned outside the United States.
- Income tax returns indicate U.S. dollars and have been adjusted for any exchange rate fluctuations. The income may be used to qualify.

When the borrower is a non-permanent resident alien employed in the United States by a foreign corporation, the income may be used to qualify when employment, residence, and credit have been verified for a minimum 2-year period.

Income must be documented with the following:

- Most recent 2 years' signed federal tax returns.
- Most recent year-to-date paystub covering at least 30 days of income.
- 2 years W-2's.

Employed abroad by a foreign company, the income is ineligible for qualifying.

**Foster Care
Income**

Income received for foster care may be used if received on a regular basis for at least 2 years and is expected to continue for the next 3 years.

Documentation must be provided by 1 of the following:

- Letter from organization providing income.
- 2 most recent federal tax returns.
- Bank statements or deposit slips that support a 2 year history.

**Housing or
Parsonage
Allowance**

A non-military housing or parsonage allowance may be considered qualifying income, if the income has been received for the most recent 12 months. The housing allowance may not be used to offset the monthly housing payment.

All of the following income documentation is required:

- Written Verification of Employment, letter from employer, or paystubs reflecting the amount of the housing or parsonage allowance.
- Terms under which the housing or parsonage allowance is paid.
- Proof of receipt of housing allowance for most recent 12 months.

**Interest &
Dividend
Income**

A 2-year average of interest and dividend income may be used to qualify if supported by sufficient assets after closing to support continuance of the interest or dividend income for at least 3 years.

The asset providing the interest and dividend income may not be liquidated for cash to close unless that portion used is deducted and the interest and/or dividend amount is recalculated based on the unused portion of the asset.

Evidence of sufficient assets after closing to support continuance of the interest and/or dividend and 1 of the following types of income documentation is required:

- Most recent 2 years personal tax returns with all schedules.
- Most recent 24 months personal bank statements.
- Most recent 2 years 1099s.

This amount must be averaged unless declining, and then the most recent 12 months will be averaged.

**Military
Income**

Military Personnel

- Military personnel may be entitled to different types of pay in addition to their base pay. Hazard or flight pay, rations, clothing allowance, quarter's allowance, and proficiency pay may be counted as income if they are verified as regular and continuous.
- Reserves or National Guard
- Not Called to Active Duty
- Military Reservists who have not been called to active duty may use their military reserve income to qualify, as long as they can provide a 2-year history of receiving that income.

Called to Active Duty

If 1 of the borrowers is on active duty or has been called to active duty after the loan application has been made, the loan is in process and wants to refinance his or her primary residence, which the family does not currently occupy, comply with the following:

- The borrower must certify that the subject property is their primary residence.
- The subject property must be vacant, will remain vacant and will again be the borrower's primary residence when the temporary assignment is completed.
- The borrower must certify that they will return to the subject property as their primary residence upon completion of the temporary assignment.
- The borrower must provide documentation regarding the temporary assignment (orders supporting the assignment including duration).

Borrower Qualification for using Military Income

- If the loan is a primary residence rate and term refinance and the borrower's mortgage payment is not changing or is being reduced, the transaction is qualified based on the borrower's current job and income.
- If the loan is a purchase, rate and term refinance or a cash out refinance of a primary residence and the mortgage payment is increasing or
- Second home or investment property, the borrower's income must be re-evaluated for qualification purposes. The borrower must be qualified using the lesser of the following:
 - Reservist pay.
 - Current job (or a combination of reservist pay and current job pay i.e., current employer pays reservist his/her standard pay minus reservist income).

**Shift
Differential**

Shift differential is paid as an incentive to employees who work shifts, such as evenings, nights, or weekends. Shift differential that is a permanent component of a borrower's

income can be considered as stable qualifying income without a history of receipt.

- If the shift differential varies periodically, a minimum 1 year history is required.
- The employer must confirm the borrower will continue to receive the income.
- Receipt of shift pay must be supported by the current paystub as well as by the prior year's earnings shown on the Verification of Employment (VOE) or W-2's.

**Tip and
Gratuity
Income**

Tip income, averaged over a 2-year period, may be included for loan qualification purposes provided it meets the following requirements and documentation is provided:

- The borrower must have a 2-year history evidencing receipt of tip income.
- The tip income must be stable or increasing, and likely to continue.
- Provide a Verification of Employment Letter or 2 years of personal income tax returns (including W-2's).
- A current paystub with year-to-date earnings for the most recent 30 days.
- If the tip income is not reported on the pay stub or income tax returns, it may not be used for qualifying or as a compensating factor.

**Non-taxable
Income**

A borrower who receives non taxable income has greater spending power than someone who is paying taxes on his or her earnings.

To equalize this tax difference for qualifying purposes the nontaxable income may be grossed up.

- The adjusted income, known as "Grossed Up" Income, is combined with taxed income for use in calculating debt ratios. The result is an accurate evaluation of the borrower's overall repayment ability.
- Document and Determine Tax Status.

If it is necessary to gross up the income for qualification purposes, a tax return must be provided by the borrower to confirm the tax exempt status.

Although some types of income, such as social security benefits, are typically perceived as tax exempt, there may be instances when taxes are applicable depending on other sources of income and filing status.

If the borrower is unable to document tax exempt status, the income cannot be grossed up for qualification purposes.

If a borrower is not required to file a tax return, a letter of explanation from the borrower, along with a signed 4506T to confirm the tax exempt status must be obtained.

If it is not necessary to gross up the income for qualification purposes, the income must be documented per the specific income guidelines.

Non taxable income may be "Grossed Up" 25% for qualifying purposes.

In the event that the tax returns reveal only a portion of income (such as social security benefits) as taxable, only those wages untaxed may be grossed up.

For example, line 20a of the 1040 shows total social security benefits of 16,020, yet the taxable amount on line 20b is 10,000. The gross up factor would be applicable to only \$6,020 of the social security benefits.

Some Bond programs, investor or agency criteria have specifically disallowed grossed-up income. The 1008 should be clearly documented with the calculation of income as well as a description of the source used to determine the income was tax exempt. If a percentage obtained from the tax table is used, a copy of the table must be included in the file.

The 1008 should be clearly documented with the calculation of income as well as a description of the source used to determine the income was tax exempt.

The following is a list, although not all inclusive, of potentially tax exempt sources of income. The tax returns will determine tax exempt status.

- Accident and health insurance proceeds
- Black lung benefit payments
- Casualty insurance payments
- Child support payments
- Clergy housing allowance
- Damages awarded for physical injury or sickness
- Federal Employee's Compensation Act payments
- Food stamps
- Foster care payments
- Government cost of living allowances
- Interest on state or local obligations (tax-free bonds)
- Military allowances (quarters, rations, and variable housing allowance-VHF)
- Military and government disability pensions
- Section 8 Homeownership Assistance Payments (if income can be verified to be nontaxable and its tax-exempt status is likely to continue)
- Social Security Income
- Supplemental security income
- Veteran's benefits (do not confuse Department of Veterans Affairs (VA) pension with military retirement)
- Welfare benefits
- Worker's compensation

Note Income Income from notes receivable can be used as qualifying income with proper documentation. All of the following documentation is required:

- A copy of the executed note documenting the payment amount and a remaining term of at least 3 years.
- Proof the borrower has received the payments on a consistent basis for the past 12 months.
- This proof may be bank statements for the last 12 consecutive months reflecting the deposit of the income, or the borrower may provide income tax returns.

Public Assistance Programs

Public assistance may be considered as acceptable income provided the income has been received for the last 2 years and is expected to continue for the next 3 years. See [Seasonal Unemployment section](#) for details regarding the use of unemployment income. All of the following income documentation is required:

- Letters or exhibits from the paying agency establishing the amount, frequency and duration of these payments.
- Document a 2-year history of receipt of income.

Retirement Pension, Annuity Income and IRA Distributions

Retirement and pension income may be used to qualify provided evidence of 3 years continuance of monthly annuity payment, 401k, or IRA monthly distribution is documented.

- Evidence of continuance of corporate, government, or military retirement/pension need not be documented.
- 1 of the following types of income documentation is required:
 - Letters from the organizations providing the income.
 - Copy of award letter
 - Most recent personal income tax returns with all schedules.
 - Most recent 1099.
 - Bank statements for the most recent 12 months showing regular deposit of funds.

Annuities

Annuity income may be used if properly documented. Acceptable documentation can be a copy of the annuity and signed tax returns, bank statements, or deposit slips.

The documentation provided must clearly specify:

- Payment amount.
- Duration and frequency.
- Tax returns, if used, must be signed.
- Income must continue for at least 3 years.

Royalty Payments

Ongoing income received from royalty payments, such as income from a work paid to its author or composer may be eligible for loan qualification

Verification that the income can be expected to continue for a minimum of 3 years is required. Due to fluctuating payments, income will be averaged over 2 years, based on the following Income documentation is required:

Loans

- Most recent 2 years personal tax returns with all schedules, including the related Supplemental Income and Loss Schedule (Schedule E)
- Evidence of receipt of at least 12 months must be documented.

Seasonal Part-time or Seasonal Second Job Income

Seasonal part-time or seasonal second job employment may be acceptable if the borrower has worked the job for 2 years. Due to these fluctuations, income will be averaged over the past 2 years based on all of the following income documentation is required:

- Most recent paystub(s), if available.
- Most recent 2 years W-2's or personal tax returns with all schedules.
- Written confirmation from the borrower's employer that there is a reasonable expectation that the borrower will be rehired for the next season.
- If income received cannot meet this requirement, it should only be considered a compensating factor.

Teachers

When a borrower is employed as a teacher, the annual salary must be verified. If monthly or weekly base pay is provided, the employer must verify the number of pay periods per year.

If the payout is not clear or average, the income will be based on the most recent W-2 over 12 months. Stipends or supplemental income must be documented as regular and continuous.

For teacher income paid over a 10-month period and obtaining financing during the summer months when income is not being received, the following documentation is required:

- Final year-end paystub from the school.
- Verbal Verification of Employment.
- Copy of fully executed, guaranteed contract, with no contingencies, indicating that the borrower is paid over a 10-month period.
- Qualify the borrower based on the income received on the final year-end paystub.

Trust Income

Confirm trust income and its continuance for at least 3 years by obtaining a copy of the Trust Agreement or Trustee Statement to document the following:

- Total amount of designated trust funds.
- Terms of payment and evidence of receipt.
- Duration of trust.
- What portion, if any, of income to borrower is not taxable?
- If the Trust Agreement or trustee's statement does not provide the historical level

of distributions, 1 of the following must be provided:

- Most recent personal tax returns with all schedules.
- K-1 schedule.
- 1041 fiduciary tax returns.
- A borrower's trust income may be taxed at a lower rate or it may be part of a partnership that writes off losses, which may result in no tax liability.
- Trust income is reported on the 1041 fiduciary income tax return, which includes a K-1 schedule.
- All beneficiaries of trust income receive IRS Form K-1 from the trust.

**Worker's
Compensation**

Worker's compensation benefits differ by state and benefits are usually reevaluated annually.

- A consistent and diligent effort must be made to obtain adequate information to allow the use of the income as qualifying income.
- Any worker's compensation/disability income used must be documented in the file, and the file must contain:
 - A copy of the borrower's disability policy or benefits statement to verify the amount of disability payments and to determine whether there is a contractually established termination or modification date **AND**
 - A statement from the benefit's payer (the insurance company, employer or other qualified and disinterested party) to confirm the borrower's current eligibility for the disability benefits.
 - The justification for worker's compensation/disability income used must be indicated on the Underwriter's Loan Analysis.
- Temporary income benefits are paid for injuries that are expected to medically improve, usually for a term of 2 years, or until such time that the employee can return to work.
- The worker's compensation benefit will be used as qualifying income, unless the employee will be returning to work at a set time in the immediate future (for example, within 60 days of closing).
- If the employee will be returning to work, the employer must confirm the position and rate of pay.
- A second type of worker's compensation is paid for permanent disability (which affects ability to perform a previous job, but does not prevent the individual from working) until such time as the borrower can be trained for a new occupation.
- This type of benefit usually continues for 5 to 8 years from the date of injury as a supplement to income and can only be used as qualifying income if it will continue for 3 years after closing.
- Lifetime worker's compensation benefits are paid for a catastrophic injury such as loss of sight, hearing, or limb
- Death benefits are also available for the surviving spouse and minor children.
- The duration of this income is determined by state law and may be considered as qualifying income if 3 years' continuance is established.
- Lump sum benefits are also paid to workers in lieu of temporary or permanent disability payments and are considered as savings.

- Worker's compensation is nontaxable income that may be grossed up for qualifying.
- Refer to [Nontaxable Income](#) in this section for additional information.

**Unemployment
Benefits
Income**

Unemployment compensation is acceptable income if it is properly documented by letters or exhibits from the paying agency and there is a 2-year history of receipt.

The amount, frequency, and duration must be stated in the documentation. If unemployment compensation cannot be documented as regular income, it must be deducted from the adjusted gross income.

Unemployment compensation associated with seasonal employment must have been received for at least 2 years and be likely to continue for the next 3 years. In addition, there must be a reasonable expectation that the borrower will be rehired the next season.

Seasonal employment income and unemployment compensation must be reported on the 2 most recent year's federal tax returns. If the borrower is a seasonal worker, proof of current receipt of unemployment cannot be a substitute for a current paystub to satisfy the AUS requirement.

The paystub must be from the borrower's regular employment. The following documentation is required:

- Written VOE covering 2 full years for the seasonal employment
- Proof of receipt of unemployment compensation for 2 years, if applicable,
OR
- Year-to-date paystub or salary voucher for 30 days,
- W-2's covering the 2 most recent years,
- Proof of receipt of unemployment compensation for 2 years, if applicable.

**Union
Members**

Union members, who at the direction of their union local, may work for a number of employers will have the union local verify how long the applicant has been a member and their current rate of pay.

To determine income, obtain 2 years tax returns and/or W-2's from all employers and year to date income. Develop an average number of hours worked and apply the present hourly rate of pay to determine qualifying income.

Borrowers may also receive unemployment compensation which is typically shown on the tax returns and which can be included in the average of income.

VA Benefits

Veteran's Administration benefits must be documented with copies of the letter or distribution forms from the Veterans Administration and must continue for at least 3 years. Voluntary Separation Incentive (VSI) paid to veterans that have been released from service early due to downsizing is acceptable income for qualification provided the

veteran:

- Provides the VSI awards letter or the statement accompanying the annual payment.
- Will not be using the funds to close.
- Will have sufficient funds available to live on until next payment is received (if depleting a substantial portion of assets to close).
- Divide the amount of the VSI award (annual payment) by 12 to determine the monthly income. It must be documented that the payments will continue for no less than 3 years.
- VSI payments continue for at least 12 years but were not implemented until 1992.
VA Education benefits are not acceptable income because they are offset by education expenses.

**Unacceptable
Sources of
Income**

Income from sources considered ineligible include, but is not limited to the following:

- Depletion of Assets (from Self Employment).
- Educational benefits, such as VA Education benefits or scholarships.
- Gifts, regardless of duration or amount.
- Lump sum payments such as inheritances or lawsuit settlements (may be verified as assets to close).
- Payments that are received for purchase or reimbursement of specified items.
- Retained earnings.
- Reverse Mortgage Loan Proceeds.
- Secondary income that will continue for less than 3 years.
- Taxable forms of income that the borrower does not declare on federal income tax returns.
- Unverifiable income.
- Value of a company furnished automobile.
- Value of employment benefit packages that are not received as cash wages.
- Lump sum payments of lottery earnings that is not ongoing.
- Non-borrower spouse income.
- Student loans/grants.
- Allowance income (for example, an allowance received from a family member).
- Stock options.
- Room and board received for the borrower's principal residence, unless specifically allowed per the product or program under which the loan was submitted.
- Rental income received from a second home.
- Severance Pay.
- Trailing wage earner income.
- Future income.
- Income derived from sources outside the United States (with the exception of Desktop Underwriter (DU) in certain circumstances).

- Income derived from the subject property with land being leased to another party.
 - Income derived from farm income when the property is being used for a specific purpose, such as a vineyard or bottling barns.
 - Income derived from gambling.
 - Income determined to be temporary or one-time in nature.
- Non-incidental income received from farming/agricultural use of a property.