CHAPTER 4: PAYMENT SUBSIDIES AND INCOME DETERMINATIONS

4.1 INTRODUCTION

The Agency uses payment subsidies to enhance borrower repayment ability for Section 502 loans. Many borrowers receive a payment subsidy at the time the loan is initially made and continue to receive it throughout the life of the loan. When a borrower begins to receive payment subsidy at the time the loan is made, the initial determination of the amount of payment subsidy for which the borrower qualifies is determined by the Field Office.

The Customer Service Center (CSC) is responsible for initiating payment subsidies for qualified borrowers not currently receiving payment subsidies and periodic reviews of borrowers already receiving payment subsidies.

Section 1 of this chapter describes policies and procedures related to the approval and renewal of payment subsidies. Section 2 provides detailed guidance on calculating annual and adjusted income, which are used to calculate the payment subsidies.

SECTION 1: PAYMENT SUBSIDIES *[7 CFR 3550.68]*

4.2 OVERVIEW OF PAYMENT SUBSIDIES

Payment subsidies are available only for Section 502 loans. The amount of subsidy is based upon the borrower's income. LoanServ calculates the borrower's payment subsidy. The sample calculations provided in this section are intended to help the Servicer understand how the calculation works so that the Servicer can explain the calculations to borrowers.

A. Three Types of Subsidy

1. Interest Credit

A borrower who initially received subsidy in the form of interest credit can continue to do so as long as the borrower remains eligible and continuously receives interest credit assistance. If the interest credit agreement expires but the borrower was continuously eligible for subsidy the borrower may continue to receive interest credit assistance provided the agreement is renewed within 6 months from the expiration date.

2. Payment Assistance Method 1

A borrower currently receiving payment assistance using payment assistance method 1 will continue to receive it for the initial loan and for any subsequent loan for as long as the borrower is eligible for and remains on payment assistance method 1.

3. Payment Assistance Method 2

All other eligible borrowers will receive payment assistance method 2. This includes: borrowers who receive new initial loans; borrowers obtaining subsequent loans who qualify for payment subsidy, but who are not currently receiving interest credit or payment assistance method 1; and borrowers who assume loans under new rates and terms. Borrowers who cease to receive interest credit or payment assistance method 1 for 6 months or more will receive payment assistance method 2 if they subsequently begin to receive payment subsidies. See Paragraph 4.3 B for calculating Payment Assistance Method 2.

B. Borrower Eligibility

1. Income Eligibility

Borrowers who obtain loans on nonprogram terms are not eligible for payment subsidies. To be eligible at the time of origination, a borrower must be income-eligible for a Section 502 loan -- that is, have adjusted income that does not exceed the applicable low-income limit at the time of loan approval and the applicable moderate-income limit at the time of loan closing.

To be eligible during the term of the loan, a borrower not already on payment subsidy must have adjusted income at or below the applicable low-income limit. Once a borrower begins to receive a payment subsidy, the borrower may continue to do so until the applicable formula no longer provides such assistance.

2. Occupancy Requirement

A borrower who is receiving payment subsidy must personally occupy the dwelling during the term of the loan; the borrower may be temporarily absent from the property for a period of 6 months with a reason acceptable to the Agency, such as seasonal or migratory employment, military call ups, or hospitalization. In the case of a deceased borrower, subsidy may continue for six months or until assumption of the loan is completed, whichever occurs sooner. The subsidy must be based upon income of the current occupants.

3. ***Nonprogram, Above-Moderate and Pre-August 1, 1968, Borrowers***

Payment subsidies cannot be provided in conjunction with loans made before August 1, 1968, or with loans made on above-moderate or nonprogram terms. Some of these borrowers may be eligible to refinance the loan in order to receive payment assistance, as described in Paragraph 5.3 A.

C. Loan Requirements

For borrowers to be eligible for payment subsidies, initial loans and subsequent loans made in conjunction with a new rates and terms assumption must have a term of at least 25 years. Borrowers are eligible to receive payment subsidies for subsequent loans with less than a 25 year term that are ***not*** made in conjunction with an assumption only if the borrower's initial loan had an initial term of at least 25 years.

D. Borrower Reporting Requirements

Each year borrowers receiving payment subsidies are required to report on household income, expenses, and composition. This enables the Servicer to determine whether the borrower should continue to receive a subsidy and the amount of subsidy to be provided.

Borrowers who receive payment subsidies must notify the Agency whenever an adult member of the household changes or obtains employment, the household composition changes, or if income increases by more than 10 percent. A borrower whose income decreases may report the change and ask the Servicer to determine whether the decrease entitles the borrower to additional payment subsidies.

The Servicer may establish an alternative review period to accommodate specific circumstances including the three circumstances described below.

1. Self-Employed Borrowers

For a self-employed borrower, the initial payment assistance agreement should run from the effective date of the income determination to 3 months after the end of the borrower's business fiscal year. This will allow subsequent agreements to coincide with the borrower's business fiscal year, with a 3-month overlap to provide sufficient time for the borrower to supply verification of the previous year's income. However, the review period may not exceed 12 months.

2. Unemployed Borrowers

For a borrower or adult household member receiving unemployment benefits, the benefit amount will be considered in the income calculation. Unemployment benefits will be calculated to project annual income regardless of the remaining eligibility of unemployment benefits. The term of the agreement will be no longer than 6 months.

3. Annual Payment Borrowers

For a borrower currently paying an annual installment who receives a subsequent loan, the initial payment assistance agreement, including assistance for the subsequent loan, will remain in effect until the next January 1st.

E. Recapture Requirement

Once the principal and interest on a loan is paid in full, subsidy recapture must be repaid whenever the borrower ceases to occupy the property or transfers title. If the property is temporarily unoccupied for reasons that are acceptable to the Agency recapture is not triggered. Whenever the borrower qualifies for payment subsidy for the first time, the borrower must sign *Form RD 3550-12*. See Section 5 of Chapter 2 for a full discussion of the recapture requirements.

4.3 CALCULATING PAYMENT ASSISTANCE

There are two (2) methods of payment assistance. They are payment assistance method 1 and payment assistance method 2. Payment assistance is calculated as follows:

A. Payment Assistance Method 1

The amount of payment assistance is the difference between the installment due at the promissory note rate and the amount the borrower must pay, based upon income. Borrowers receiving payment assistance method 1 must pay the ***greater of:***

- The loan payment amortized at the equivalent interest rate (EIR) applicable to the borrower; or

- Except for leveraged loans, a floor payment calculated as a percentage of adjusted income, less the cost of taxes and insurance.

Exhibit 4-1 provides an example of this calculation

Exhibit 4-1
Sample Payment Assistance Method 1 Calculation
(These calculations are done by LoanServ)

The Jones family has been approved for a loan with a principal amount of $60,000.

The following financial information is needed to calculate the payment assistance:

Loan term: 33 years **Note rate:** 7% **Median income:** $30,000

$19,000	Adjusted income
$90	Monthly taxes and insurance
64%	Percent of applicable median ($19,000 ÷ $30,000)

(1) Calculate the Payment at the Note Rate

$389	Payment at the note rate: (Amortized amount for $60,000 @ 7% for 33 years)

(2) Calculate the Floor Payment for PI*

24%	Floor payment percentage for borrower @ 64% of median income
380	Floor payment for PITI* ($19,000 ÷ 12 months x 0.24)
$290	Floor payment for PI ($380 - $90 for taxes and insurance)

(3) Calculate the Payment at the EIR*

4%	EIR for borrower at 64% of median
$273	Payment at the EIR (amortized amount for $60,000 @ 4% for 33 years)

(4) Compute Monthly Payment Assistance

$389	Payment at the note rate
-$290	Required payment is the greater of (2) or (3)
$ 99	Monthly payment assistance

***PI** ~ Principal and interest
PITI ~ Principal, interest, taxes, and insurance
EIR ~ Equivalent Interest Rate

1. Calculating the Payment at the Equivalent Interest Rate

This payment uses the borrower's loan amount, the term of the loan, and an equivalent interest rate for which the borrower qualifies based upon income. Exhibit 4-2 provides the equivalent interest rates to be used.

Exhibit 4-2
Equivalent Interest Rates

Use the equivalent interest rate for the income range applicable to the borrower's adjusted annual income.

Median Income Range	Equivalent Interest Rate*
0%-50%	1.0%
50.01%-54.99%	2.0%
55.00%-59.99%	3.0%
60.00%-64.99%	4.0%
65.00%-69.99%	5.0%
70.00%-74.99%	6.0%
75.00%-80.00%	6.5%
80.01%-89.99%	7.5%
90.00-99.99%	8.5%
100.00%-109.99%	9.0%
110.00%-or more than adjusted median income	9.5%

*EIR can never exceed the note rate and in no case be less than one percent.

2. Calculating the Floor Payment

Borrowers, except for those with leveraged loans, must pay a minimum for principal, interest, taxes, and insurance (PITI) of:

- 22 percent of adjusted income for very low-income borrowers;
- 24 percent of adjusted income for low-income borrowers with adjusted incomes at or below 65 percent of the applicable median income; or
- 26 percent of adjusted income for borrowers with adjusted income above 65 percent of the applicable median income.

B. Payment Assistance Method 2.

The amount of payment assistance granted is the lesser of the difference between:

(i) The annualized promissory note installments for the combined RHS loan and eligible leveraged loans plus the cost of taxes and insurance less twenty-four percent of the borrower's adjusted income, or

(ii) The annualized promissory note installment for the RHS loan less amount the borrower would pay if the loan were amortized at an interest rate of one percent.

Borrowers receiving payment assistance method 2 must pay to RHS the greater of:

- 24% of their adjusted annual income less the amortized payment for the eligible leveraged loan less the cost of taxes and insurance; or

- A payment to RHS based on an interest rate of 1%.

An eligible leveraged loan is a loan with payments amortized over a period of not less than 30 years and an interest rate that does not exceed three percent.

Exhibit 4-3 provides an example of this calculation.

Exhibit 4-3
Sample Payment Assistance Method 2 Calculation
(These calculations are done by LoanServ)

The Jones family received an RHS loan for $60,000 and an Affordable Leveraged Loan for $30,000.

	Principal amount	Payment Period	Note Rate
RHS Loan	$60,000	33 Years	6%
Affordable Leverage Loan	$30,000	30 Years	3%

The Adjusted Annual Income (AAI) is $23,000; monthly Taxes and Insurance are estimated at $150 per month.

1. Calculate the combined Annual Payment at the Note Rate plus Taxes and Insurance less 24% of the AAI.

$349 RHS ($60,000 @ 6% for 33 years = $4188)
$127 Affordable Leverage Loan ($30,000 @ 3% for 30 years = $1524)
<u>$150</u> Estimated Annual taxes and insurance = $1800
$626 Less
$460 AAI ($23,000 x 24% = $5520)
$166 Total monthly subsidy = $166

2. Calculate the annualized note installment less the annualized 1% installment.

$349 RHS Note Payment = $6000
<u>$178</u> RHS 1% Payment ($60,000 @1% for 33 years - $2136)
$171 Total monthly subsidy = $171

Payment subsidy will be based on option 1.

Calculate Borrower PITI

$626 (Combined Note Rate Payments Plus Taxes and Insurance)
<u>$166</u> Less Subsidy (option 1)
$460 Borrower Payment/PITI

Calculate Borrower RHS Payment

$349 RHS Note Rate
<u>$166</u> Less Subsidy
$183 Borrower Payment

4.4 CALCULATING INTEREST CREDIT

For eligible borrowers, the amount of interest credit granted is the difference between the amount due at the note rate and a minimum required borrower payment. Borrowers receiving interest credit must pay at least the ***greater of***:

- 20 percent of adjusted income, less the cost of taxes and insurance; or
- A loan payment reflecting the loan amount amortized at an interest rate of 1 percent.

Exhibit 4-4 provides an example of this calculation.

4.5 PROVIDING PAYMENT ASSISTANCE METHOD 2 TO BORROWERS NOT CURRENTLY RECEIVING A PAYMENT SUBSIDY

Borrowers not currently receiving payment subsidies generally become eligible for payment assistance as a result of a decrease in income. Borrowers may request assistance, or the Servicer may recognize that the borrower is now eligible for payment assistance as a result of interactions with the borrower.

A. Eligibility

To be eligible for payment assistance a borrower not currently receiving a payment subsidy must have income at or below the applicable low-income limit and personally occupy the dwelling. Payment assistance cannot be provided in conjunction with loans funded before August 1, 1968, or with loans made on nonprogram or above-moderate terms. However, such loans may be refinanced as a new loan to enable the borrower to obtain payment assistance, as described in Paragraph 5.3 A.

Exhibit 4-4

Sample Interest Credit Calculation

(These calculations are done by LoanServ)

The Joneses have received interest credit on their initial $60,000 loan since it was approved.

The following financial information is needed to calculate the payment assistance:

Loan term: 33 years Note rate: 7% Median income: $30,000

$19,000	Adjusted annual income	$90	Monthly taxes and insurance
64%	Percent of median ($19,000 ÷ $30,000)		

(1) Calculate the Annual Payment at the Note Rate

$389 Monthly payment at the note rate:
(Amortized amount for $60,000 @ 7% for 33 years)

(2) Calculate the Minimum Payment for Principal and Interest

$317 Minimum amount for PITI* ($19,000 ÷ 12 months x 0.20)
$227 Minimum amount for PI* ($317 - $90)

(3) Calculate the Required Payment at 1 Percent

$178 Monthly payment (amortized amount for $60,000 @ 1% for 33 years)

(4) Compute Monthly Interest Credit

$389	Monthly payment at the note rate
-$227	Required payment is the greater of (2) or (3)
$162	Monthly Interest Credit

* PITI = Principal, interest, taxes and insurance.
PI = Principal and interest.

B. Processing Requests for Payment Assistance

To determine eligibility, the Servicer sends the borrower *Form RD 3550-21*.

Based on the information provided by the borrower, the Servicer uses LoanServ to compute the amount of payment assistance and, if the borrower is eligible, generates *Form RD 1944-14, Payment Assistance/Deferred Mortgage Assistance Agreement*. The Servicer notifies eligible borrowers by letter. The letter should include *Form RD 1944-14* and, if the borrower has not previously signed a subsidy repayment agreement *Form RD 3550-12*. This agreement requires the borrower to repay the subsidy when the borrower sells the property, refinances the loan, moves out of the property, or pays the loan in full.

C. Effective Date of Payment Assistance

New payment subsidy is made effective on the due date following receipt and processing of executed documents from the borrower.

4.6 ANNUAL AND INTERIM REVIEWS OF PAYMENT SUBSIDIES

A. Annual Reviews

Subsidy agreements are effective for a period not exceeding 24 months. For agreements that exceed 12 months an annual review is conducted by CSC to determine the borrower's continued eligibility for subsidy.

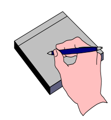
Before the anniversary date of an existing subsidy agreement for a term exceeding 12 months, the CSC Servicer will initiate an annual review. To complete this review the Servicer notifies the borrower that the current agreement will remain unchanged and continued for another 12 months unless there has been a 10 percent change in income. If the borrower notifies CSC of a change, the Servicer records the notification and requests verification of the new information provided by the borrower. Approximately 90 days before expiration of the current subsidy agreement, CSC will initiate a more extensive annual review process. Renewal processing should be completed in time for a new payment subsidy amount to be effective on the expiration date of the borrower's current subsidy agreement.

The LoanServ system will identify cases due for review. To complete the renewal process the Servicer sends each borrower Form RD 3550-21, “Payment Subsidy Renewal Certificate,” to request information on household income, expenses, and composition. When the borrower returns the information, the Servicer verifies the information provided as described in Paragraph 4.8 B.

When all necessary verifications are complete, the Servicer uses LoanServ to compute the amount of payment subsidy and, if the borrower is eligible, notifies the borrower by letter of the required monthly payment.

B. Interim Reviews

Borrowers who receive payment subsidies must notify the Agency whenever an adult member of the household changes or obtains employment, the household composition changes, or if income increases by more than 10 percent. A borrower whose income decreases may report the change and ask CSC to determine whether the decrease entitles the borrower to additional payment subsidy. A change in payment subsidy will not be made unless the scheduled principal and interest payment would change by at least 10 percent as a result of the change in household circumstances.



Whenever a borrower notifies CSC of a change, the Servicer records the notification and requests verification of the new information provided by the borrower, as necessary. The Servicer:

- Uses LoanServ to recompute the borrower’s payment subsidy and to generate the appropriate subsidy agreement.

- Notifies the borrower of any change in the required monthly payment.

- Makes increases in the required monthly payment effective after <u>30 days</u> notice to the borrower. Decreases in the required monthly payment should be made effective with the next payment due.

The borrower’s next annual review is typically scheduled for 12 months after the effective date of the change in payments.

C. In-Depth Reviews

CSC will conduct in-depth reviews of borrower income on a random basis of at least one percent of renewals completed for the purpose of quality control. In addition, an in-depth review will be conducted where a borrower's Form RD 3550-21 appears to be inaccurate or the Agency receives information which conflicts with the information provided by the borrower. Quality Control Reviews will be performed by using IRS Form 4506-T, "Request for Transcript of Tax Return". All adult members within the selected households are required to complete and submit IRS Form 4506-T to CSC to allow for independent verification of tax information with the IRS. Cases where unauthorized assistance has been reported may also be subject to review.

D. Trust Loan Borrowers

If payment subsidy is processed to a borrower who also has a Trust loan, the Trust loan servicer should be notified to assure that the combined calculations are correct and to avoid possible duplication of efforts for the borrower, RHS, and the Trust.

SECTION 2: EVALUATING BORROWER INCOME

[7 CFR 3550.53(a) and (g), 7 CFR 3550.54]

4.7 Overview

The Loan Servicer uses income information to help determine whether a borrower is eligible for payment subsidy and the amount of that subsidy. This section provides guidance for verifying and calculating income for each of these purposes. Additional examples are based on Housing and Urban Development (HUD) Handbook 4350.3

A. Key Concepts for Income Determinations

1. Income Definitions

Three income definitions are used by the Agency. Whenever income determinations are made, it is essential that the Servicer uses the correct income definition and considers income from the appropriate household members. ***Repayment income*** is used during servicing only to determine if a borrower is eligible for a Moratorium or Reamortization. Only the income of parties to the note is considered when calculating repayment income. To determine whether a borrower is income-eligible for payment subsidies, the Servicer must use ***adjusted income***. Adjusted income is calculated in two steps. First, the ***annual income*** of all household members is calculated. Then, certain household deductions for which the household may qualify are subtracted from annual income to compute adjusted income.

- **Annual Income** is the amount of income that is used to determine a borrower's eligibility for assistance. Annual income is defined as all amounts, monetary or not, that go to, or are received on behalf of, the borrower, co-borrower, spouse or non-spouse of borrower (even if the household member is temporarily absent), or any other household member; all amounts anticipated to be received from a source outside the family during the 12-month period, all amounts that are not specifically excluded by regulations, and amounts derived (during the 12-month period) from assets to which any member of the family has access.

- **Adjusted Income** is used to determine whether a household is income eligible for payment assistance. It is based on annual income and provides for deductions to account for varying household circumstances and expenses.

- **Repayment Income** is used to determine whether a borrower has the ability to make monthly loan payments. It is based only on the income attributable to parties to the note and includes some income sources excluded for the purpose of adjusted income. Repayment Income is used during servicing **<u>only</u>** to determine if a borrower is eligible for a Moratorium or Reamortization as described in Paragraph 5.5.

2. Whose Income To Count

For repayment income, the Loan Servicer must consider only the income of household members who are parties to the note. For adjusted income, the income of all household members must be considered. For both repayment and adjusted incomes, live-in aides, foster children, and foster adults living in the household are not considered household members.

An individual permanently confined to a nursing home or hospital may not be applicant or co-applicant but may continue as a family member at the family's discretion. The family has a choice with regard to how the permanently confined individual's income will be counted. **The family may elect <u>either</u> of the following**:

- ***Include*** the individual's **income and receive allowable deductions** related to the medical care of the permanently confined individual; or

- ***Exclude*** the individual's **income and not receive allowances** based on the medical care of the permanently confined individual.

Exhibit 4-5 is a table which lists whose income is to be counted.

EXHIBIT 4-5

INCOME TO BE COUNTED

Members	**Employment Income**	**Other Income** (including income from assets)
Borrower, Co-Borrower	Yes	Yes
Spouse, Co-Spouse/Non-Spouse	Yes	Yes
Other Adult	Yes	Yes
Permanently Confined Family Member	Optional*	Optional*
Dependents (children under 18)	No	Yes
Full-time Student over 18	See Note	Yes
Non-Members		
Foster Child	No	No
Foster Adult	No	No
Live-in Aide	No	No

NOTE: The earned income of a full-time student 18 years old or older who is not the Borrower, Co-Borrower or Spouse is excluded after it exceeds $480.

***Remember:** The family chooses at loan closing to include or exclude the permanently confined individual's income.

3. Income Limits

Some program rules differ according to the income of the borrower. Three different income limits are used for the Section 502 and 504 programs. The National Office provides the income limits and updates the limits whenever they are revised. The income limits are included in Appendix 9. ***Adjusted income*** should be compared to the income limit to determine the category in which each household falls. Income limits are as follows:

- The very low-income limit is established at approximately 50 percent of the median income for the area, adjusted for household size;

- The low-income limit is established at approximately 80 percent of the median income for the area, adjusted for household size; and
- The moderate-income limit is established by adding $5,500 to the low-income limit for each household size.

To receive payment assistance, borrowers not currently receiving subsidy must have adjusted income at or below the applicable low income limit. Borrowers currently receiving payment subsidies do not have to meet an income threshold.

Whenever verification from a third party is requested, a copy of *Form RD 3550-1, Authorization to Release Information,* **must** accompany the request. Authorization from each adult household member on the *Form RD 3550-1* permits the Loan Originator/ Servicer to ask for, and verification sources to release, the needed information. The verification and certification formats that are provided in Appendix 2 are not official Agency forms. They are samples that may be adapted as needed for particular circumstances. In some instances the same format can be used whether a third party is providing the verification or the borrower is making a certification.

- **Wage and Salary Income.** Income from employment may include a base hourly wage or salary, overtime pay, commissions, fees, tips, bonuses, housing allowances, and other compensation for personal services of all adult members of the household. When the borrower demonstrates a stable or rising income, current income from each of these sources may be used unless there is evidence to the contrary (such as the employer's indication that such income is NOT likely to continue).

Example – Stable Income

Steven Green has been working for the last 6 months for LMN Contractors as a Construction Foreman. Before that, he worked for PDQ Building Supply for 8 months as a Shift Supervisor. There is a 6-week gap in his employment history that he explains as being the result of a lay-off after a large construction project (where he was employed for 15 months as a construction worker) was completed.

Mr. Green's income is considered stable because the reasons for his job changes were related to changes in job opportunities. Even though his job changed several times, his line of work was similar.

Example – Dependable Income

Mary Brown receives SSI income for her dependent child who is 17 years of age. The SSI income should not be counted as repayment income because it clearly cannot be expected to continue.

It would be counted as annual income since it is current verified income.

- **Self-employment Income.** Income based on a one-year history of self-employment, in the same line of work, is an acceptable indicator of stable and dependable income.

Example – Self-Employment Income – (irregular income)

Julie McAhren sells beauty products door-to-door on commission . She makes most of her money in the months prior to Christmas but has some income throughout the year. She has no formal records of her income other than a copy of the IRS Form 1040 she files each year. With no other information available, use the income reflected on Julie's copy of her Form 1040 as her annual income.
Betty House sells real estate on commission. She makes most of her money during the summer months.

She has no formal records of her income other than a copy of a W-2 and the Tax Return (Form 1040) she files each year. The gross earning on the W-2 would be used as her annual income.

- **Other Sources of Income.** Income from public assistance, child support, alimony, or retirement that is consistently received is considered stable when such payments are based on a law, written agreement or court decree, the amount and regularity of the payments, the eligibility criteria for the payments, such as the age of the child (when applicable), and the availability of means to compel payments.

Examples – Other Sources of Income

Janis Phillips is not always well enough to work full-time. When she is well, she works as a typist with a temporary agency. Last year was a good year and she worked a total of nearly six months. This year, however, she has more medical problems and does not know when or how much she will be able to work.

Because Ms. Phillips is not working at the time, it will be best to exclude her employment income and remind her that she must report the date when she resumes work.

Sam Shah receives social security disability. He reports that he works as a handyman periodically. He cannot remember when or how often he worked last year; he says it was a couple of times. Sam's earnings appear to fit into the category of nonrecurring, sporadic income that is not included in annual income.

Mr. Shah's earnings will not be included in his annual income this year, but he must report any regular work or steady jobs he takes.

Ken Hammer receives social security disability. He reports that he works as a handyman periodically. He cannot remember when or how often he worked last year. He says it was a couple of times last year, however, his tax return does not indicate any gross wages from his handyman work.

Mr. Hammer's income would be considered nonrecurring and sporadic income and would not be included in annual income.

- **Seasonal Income.** Seasonal job income may be considered stable income when the borrower has worked in the same line of seasonal work for at least one year. When the borrower receives seasonal unemployment compensation, it must be clearly associated with seasonal layoffs expected to recur and be reported on the borrower's federal income tax returns.

Examples – Irregular Income (e.g. seasonal income)

Ross Bosser is a roofer who works from April through September. He does not work in rain or windstorms. His employer is able to provide information showing the total number of regular and overtime hours Ross worked during the past two years.

To calculate Ross's anticipated income, use the average number of regular hours over the past three years times his current regular pay rate, and the average overtime hours times his current overtime rate.

- **Less Than Two Years of History.** In some cases, a history of less than two years is acceptable. The determination requires a careful analysis by the Loan Servicer. This may include a borrower who is either new to the work force or has returned to the work force after an extended absence. In these cases, the Loan Servicer must look at the period of time the borrower has been employed, the employer's evaluation of the likelihood of continued employment (if available), education or training that qualifies the borrower for his/her current position (typically applies to skilled positions), and reasons for absence from the work force in making a determination that income is stable and likely to continue. Information provided by the borrower must be verified by the Loan Servicer.

Example – Less Than Two Years History

For the last few years, Ellen Dixon has been a homemaker with no outside employment. Now that her children are old enough, she has taken a job as a teacher for which she has the necessary education and certifications. She completed her 6-month probation period and her employer considers that she is a permanent employee. Ms. Dixon's income can be considered stable and dependable.

It is important to note that had Ms. Dixon not met the employer's probation period, her income would be counted in annual and adjusted income since it is current verified income but not for repayment ability because it is not considered stable and dependable.

B. Using LoanServ and the Income Worksheet to Compute Income

All three types of income are calculated in LoanServ using data entered by the Servicer. **Attachment 4-A**, a Worksheet for Computing Income calculator that helps the Servicer organize borrower's information for data entry and provides instructions to calculate each type of income -, If the worksheet is used to calculate income, place a copy in the borrower's file.

4.8 SOURCES & VERIFICATION OF INCOME

The Loan Servicer will consider sources of income to determine annual and repayment income. This section provides guidance on income that will and/or will not be counted.

A. For annual income, consider income from the following sources that are attributable to any household member. For repayment income, consider income from the following sources that are: attributable to parties to the note and represent a source of dependable income.

1. The gross amount, before any payroll deductions, of base wages and salaries, overtime pay, commissions, fees, tips, bonuses, housing allowances, and other compensation for personal services of all adult members of the household. If a cost of living allowance or a proposed increase in income has been estimated to take place on or before loan approval, loan closing, or the effective date of the payment assistance agreement, it will be included as income. For **annual income**, count only the first $480 of earned income from adult full-time students who are not the borrower, co-borrower, or spouse.

Employer paid and provided fringe benefits <u>are not included</u> in annual income regardless of whether the benefits are reported on the employee wage statement. **Fringe benefits may include, but are not limited to:**

- Child care/pet-sitting
- Medical/life insurance
- Car/mileage allowance
- Stock options
- Discounts for merchandise
- Sport/concert/movie tickets or entertainment
- Charity donations in employee name
- Any reimbursement of actual work expenses

Housing allowances may include, but are not limited to:

- Cash or non-cash contributions paid on behalf of the applicant/borrower by persons not living in the house
- Allowances for members of the Armed Forces
- Allowances for members of the Clergy
- Allowances paid by Employer

2. The <u>net</u> income from the operation of a farm, business, or profession. The following provisions apply:

   - Expenditures for business or farm expansion, capital improvements, or payments of principal on capital indebtedness shall not be used as deductions in determining income. A deduction is allowed in the manner prescribed by Internal Revenue Service (IRS) regulations only for interest paid in amortizing capital indebtedness.

   - Farm and non-farm business losses are considered "0" in determining annual income. A negative amount must **not** be used to offset other family income.

- A deduction, based on straight-line depreciation, is allowed in the manner prescribed by IRS regulations for the exhaustion, wear and tear, and obsolescence of depreciable property used in the operation of a farm, business, or profession by a member of the household. The deduction must be based on an itemized schedule showing the amount of straight-line depreciation.

- Any withdrawal of cash or assets from the operation of a farm, business, or profession, or salaries or other amounts distributed to family members from the farm, business, or profession, will be included in income, except to the extent the withdrawal is for reimbursement of cash or assets invested in the operation by a member of the household.

- A deduction is allowed for verified business expenses, such as lodging, meals, and fuel, for business trips made by salaried employees, such as long-distance truck drivers, who must meet these expenses without reimbursement.

- For home-based operations such as child care, product sales, and the production of crafts, housing related expenses for the property being financed such as mortgage interest, real estate taxes, and insurance, which may be claimed as business expense deductions for income tax purposes, will not be deducted from annual income.

3. Interest, dividends, and other net income of any kind from real or personal property, including:

    - The share received by adult members of the household from income distributed from a trust fund.

    - Any withdrawal of cash or assets from an investment except to the extent the withdrawal is reimbursement of cash or assets invested by a member of the household.

4. The full amount of periodic payments received from Social Security (including Social Security received by adults on behalf of minors or by minors intended for their own support), annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts. However, deferred periodic amounts from supplemental income and social security benefits that are received in a lump sum amount or in prospective monthly amounts are not counted.

Example – Adjustment for Prior Overpayment of Benefits

Dan Steven's social security payment of $250 per month is being reduced by $25 per month for a period of six months to make up for a prior overpayment.

Count Dan's social security income as $225 per month for the next six months and as $250 per month for the remaining six months.

5. Payments in lieu of earnings, such as unemployment and disability compensation, worker's compensation, and severance pay.

6. Public assistance **except** as indicated in **Paragraphs 4.8 C. and D.**

7. Periodic allowances, such as:

- Alimony and child support awarded by the court in a divorce decree or separation agreement unless the applicant certifies the payments are not received, and the applicant provides documentation to the Agency that he or she has taken all reasonable legal actions to collect amounts due, including filing with the appropriate courts or agencies responsible for enforcing payment; or
- Recurring monetary gifts or contributions from an organization or person who is not a member of the household.

Examples – Regular Cash Contributions

The father of a young single parent pays her monthly utility bills. On average, he provides $100 each month. The $100 per month must be included in the family's annual income.

The daughter of an elderly applicant gives her mother $175 each month to assist with her living expenses. The daughter plans to continue subsidizing her mother's expenses. The $175 per month must be included in the annual income.

8. All regular pay, special pay (except for persons exposed to hostile fire), and allowances of a member of the armed forces who is the applicant or spouse, whether or not that family member lives in the home.

B. Consider these additional sources of income that are attributable to parties to the note and represent a source of dependable income for <u>repayment income</u> only.

1. Housing Assistance payment (HAP). (HUD's Housing Choice Voucher-Homeownership Program sometimes referred to as Section 8 for Homeownership.) For additional information on the Housing Choice Voucher – Homeownership Program, visit http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/programs/hcv/homeownership

2. Adoption assistance payments in excess of $480 per adopted child.

3. Reparation payments paid by a foreign government arising out of the Holocaust.

4. The full amount of student financial assistance received by household members or paid directly to the educational institutions who are parties to the note. Financial assistance *includes* grants, educational entitlements, work- study programs, and financial aid packages. It *does not include* tuition, fees, student loans, books, equipment, materials and transportation. Any amount provided for living expenses may be counted as **<u>repayment income</u>**.

5. Amounts received by the family in the form of refunds or rebates under State or local law for property taxes paid on the dwelling unit.

6. Any other revenue which a Federal statute exempts, will be considered **<u>repayment income</u>.** This includes:

   - The imminent danger duty pay to a service person borrower or spouse away from home and exposed to hostile fire.
   - Payments to volunteers under the Domestic Volunteer Service Act of 1973, including, but not limited to:

- ◊ National Volunteer Antipoverty Programs which include Volunteers In Service To America (VISTA), Peace Corps, Service Learning Programs, and Special Volunteer Programs.

- ◊ National Older American Volunteer Programs for persons age 60 and over which include Retired Senior Volunteer Programs, Foster Grandparent Program, Older American Community Services Program, and National Volunteer Programs to Assist Small Business and Promote Volunteer Service to Persons with Business Experience, Service Corps of Retired Executives (SCORE), and Active Corps of Executives (ACE).

- Payments received after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the "In Re Agent Orange" product liability litigations, M.D.L. No. 381 (E.D.N.Y.).
- Payments received under the "Alaska Native Claims Settlement Act" or the "Maine Indian Claims Settlement Act."
- Income derived from certain sub-marginal land of the United States that is held in trust for certain American Indian tribes.
- Payments or allowances made under the Department of Health and Human Services Low-Income Home Energy Assistance Program.
- Payments received from the Job Training Partnership Act.
- Income derived from the disposition of funds of the Grand River Band of Ottawa Indians.
- The first $2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the Court of Claims, or from funds held in trust for an American Indian tribe by the Secretary of Interior.
- Payments received from programs funded under Title V of the Older Americans Act of 1965.
- The value of the allotment provided to an eligible household under the Food Stamp Act of 1977.
- Any other income which is exempted under Federal statute.

7. Amounts paid by a State Agency to a family with a developmentally disabled family member living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member in the home.

8. The special pay to a family member serving in the Armed Forces who is exposed to hostile fire.

9. Income received from the Supplemental Nutrition Assistance Program (SNAP) may be considered to calculate repayment income in an amount **not to exceed 20 percent of the total repayment income** ("not to exceed" amount). The following provisions apply:

- Only the SNAP benefits attributable to the note signers can be considered for repayment income.
- Only **the lesser** of the "not to exceed" amount or the actual SNAP benefits can be included in the applicant's repayment income.

Example – Income from SNAP Benefits

Eloise Thompson's monthly income from employment is $800. She also receives $200 per month in child support payments for her 6-year-old daughter and $200 per month in SNAP benefits. To consider the SNAP benefits in the repayment income calculation, the "not to exceed" amount must be calculated.

Monthly repayment income excluding SNAP benefits ($800 + $200):		$1,000
To calculate Income from SNAP benefits:		
1. Equalize the repayment income ($1,000 / .80):	$1,250	
2. Calculate the "not to exceed" amount ($1,250 - $1,000):	$ 250	
3. Compare to actual SNAP benefits received:	$ 200	
The **lesser** of the "not to exceed" amount or the actual SNAP benefits:		$ 200
Monthly repayment income after SNAP consideration:		$1,200

C. The following sources are *never* considered when calculating annual income or repayment income:

1. Income from the employment of persons under 18 years of age, except parties to the note and their spouses.

2. Income *received by* foster children or foster adults who live in the household, or live-in aides, regardless of whether the live-in aide is paid by the family or a social services program (family members cannot be considered live-in aides unless they are being paid by a health agency and have an address, other than a post office box, elsewhere).

3. Special-Purpose Payments. These are payments made to the borrower's household that would be discontinued if not spent for a specific purpose. Payments which are intended to defray specific expenses of an unusual nature and which are expended solely for those expenses should not be considered as income. Examples include, but are not necessarily limited to, the following:

   a. Medical Expenses. Funds provided by a charitable organization to defray medical expenses, to the extent to which they are actually spent to meet those expenses.

   b. Foster Children/Adults. Payments for the care of foster children or adults. NOTE: Foster children are not considered members of the family. Therefore, no adjustments to income are to be made because of their presence.

4. Temporary, nonrecurring, or sporadic income (including gifts).

5. Lump-sum additions to family assets such as inheritances, capital gains, insurance payments included under health, accident, hazard, or worker's compensation policies, and settlements for personal or property losses.

6. Amounts that are granted specifically for, or in reimbursement of, the cost of medical expenses for any family member.

7. Payments received on reverse amortization mortgages (these payments are considered draw-down on the applicant’s assets).

8. Amounts received by any family member participating in programs under the Workforce Investment Act of 1998 (29 U.S.C. 2931):

- Amounts received by a person with a disability that are disregarded for a limited time for purposes of Supplemental Security Income eligibility and benefits because they are set aside for use under a Plan to Attain Self-Sufficiency (PASS).
- Amounts received by a participant in other publicly assisted programs which are specifically for or in reimbursement of out-of-pocket expenses incurred (special equipment, clothing, transportation, child care, etc.) and which are made solely to allow participation in a specific program.

9. Earned income tax credits.

- Incremental earnings and benefits resulting to any family members from participation in qualifying State or local employment training programs (including training programs not affiliated with a local government) and training of a family member as resident management staff. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for the period during which the family participates in the employment training program.
- Allowances, earnings and payments to AmeriCorps participants under the National and Community Service Act of 1990 (42 E.S.C. 12637{d}).

D. In addition, the following sources are *never* considered when calculating <u>annual income</u>:

1. Payments received for the care of foster children or foster adults (usually individuals with disabilities who are unable to live alone).

2. Deferred periodic payments of supplemental security income and Social Security benefits that are received in a lump sum amount or in prospective monthly amounts.

3. Any amount of crime victim compensation received through crime victim assistance (or payment or reimbursement of the cost of such assistance) because of the commission of a crime against the borrower under the Victims of Crime Act (42 U.S.C. 10602).

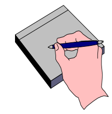
4. Any allowance paid under 38 U.S.C. 1805 to a child suffering from spina bifida who is the child of a Vietnam veteran.

5. Payments by the Indian Claims Commission to the Confederated Tribes and Bands of Yakima Indian Nation or the Apache Tribe of Mescalero Reservation (Pub.L. 95-433).

6. Housing assistance payment (Section 8 Homeownership Voucher).

7. Adoption assistance payments in excess of $480 per adopted child.

E. **Verifying Sources and Amounts**



Each borrower must provide information about income, expenses, and household composition to enable the Agency to make income determinations. For payment subsidy renewals borrowers must report income information using *Form RD 3550-21*, *Payment Subsidy Renewal Certification*, and provide the following documentation:

- Each adult household member listed on the certification must provide a copy of the latest Federal income tax return, and if the adult is employed, copies of the last two pay stubs. Where the amount of income verified through other means differs significantly from the last tax return, the borrower or employer, as appropriate, should be contacted to ascertain the correct income.

- Each adult household member must sign a copy of *Form RD 3550-1*, *Authorization to Release Information*. Copies of this form must accompany any request for verification from third-party sources. Appendix 2 provides sample certification and verification formats for a number of purposes.

- *A*ny member that receives income from nonemployment sources such as pensions, Social Security, Supplemental Security Income, worker's compensation, public assistance, alimony, or child support must provide a copy of the latest award letter or other documentation of the income received from that source.

The Loan Servicer must review the information provided by the household and determine if any additional verification is required. Written verifications should be provided by third parties when the Loan Servicer determines that it is needed or when conducting quality control reviews. Oral verifications may be accepted if written verifications are not feasible but should be carefully documented. Appendix 2 contains several verification and certifications that may be used to verify various income and expenses.

Type of Income or Verification Source	Verification Requirements and Procedures
INCOME (If **Preferred Source** of verification can not be obtained without cost, **Acceptable Alternative** may be used.)	
WAGES or SALARIES	
Verification of Employment *Preferred Sources*	The borrowers must list all household members on *Form RD 3550-21, Payment Subsidy Renewal Certification,* and provide their employment status. Each adult household member listed on the certification must provide the latest year's Federal Income Tax Return(s), two current consecutive pay stubs, or earnings statements with year-to-date income. *IRS Form 4506-T, Request for Transcript of Tax Return,* may be used to obtain a copy of a transcript of tax return(s) if the borrower can not provide copies of actual returns filed.
Paycheck Stubs or Payroll Earnings Statements for not less than two (2) weeks *Acceptable Alternatives*	They must be the "most recent" as of the date the verification is submitted and must clearly identify the adult household member as the employee by name and/or social security number; must show the gross earnings for that pay period and year-to-date; and must be computer-generated or typed. Form RD 1910-5, *Verification of Employment*, must be completed and signed by the employer. A signed statement from the employer may be used to support or clarify income information provided.
Electronic Verification *Acceptable Alternative*	Electronic printout must clearly identify the adult household member as the employee by name and/or social security number, cover the most recent pay period as of the date the verification is submitted, and show gross earnings for the most recent 30-day pay period and year-to-date.
Oral Verification as permitted in Paragraph 3.15 A.2. of HB-1-3550 *Acceptable Alternatives*	Document the date of contact and list: The employer's name/address/phone number/contact person and title; the employee's name, date of employment, present position and probability of continued employment; the amounts of current base pay and other income such as overtime, bonus, commissions, etc. along with the likelihood that the level of current earnings will continue; and the name and title of the Rural Development employee that contacted the employer.

Type of Income or Verification Source	Verification Requirements and Procedures
SELF-EMPLOYMENT	
Income & Expense Statement *Preferred Source*	Self-employed adult household members must provide current documentation of income and expenses, which cannot be older than the previous fiscal year. The Loan Servicer must compare the income and expense information provided with the latest Federal Income Tax Return (IRS Form 1040) along with Schedules C & F and/or other applicable schedules, and clarify any discrepancies. For first year business, household member must provide Profit and Loss Statement (projected or actual). *IRS Form 4506-T* may be used to obtain a copy of a transcript of tax return(s) if the borrower can not provide copies of actual returns filed.
Acceptable Alternative	Two most recent bank statements showing the amount of monthly benefits received; or electronic printouts of federal tax forms & schedules (or State Return if gross income is itemized) showing the breakdown of gross income.

Type of Income or Verification Source	Verification Requirements and Procedures
SUPPLEMENTAL VERIFICATION	
Seasonal Employment *Preferred Source*	A household member who is a seasonal worker must provide the most recent Federal Income Tax Return, the prior year's W-2s and/or prior year's 1098 statements. *IRS Form 4506-T* may be used to obtain a copy of a transcript of tax return(s) if the borrower can not provide copies of actual returns filed.
Unemployment and Unemployment Benefits, Disability & Worker's Compensation, Severance Pay (except lump-sum additions) *Preferred Source*	If a borrower has recently become unemployed, the Loan Servicer should contact the former employer to confirm that the borrower is no longer employed and that re-employment is not expected. Adult household members receiving <u>unemployment</u> benefits must provide the most recent award or benefit letter prepared by the authorizing agency to verify the <u>non-employment</u> income. Appendix 2 provides a sample format for requesting information about unemployment benefits. Must clearly identify the adult household member as the employee by name and/or social security number. Must cover the most recent earnings as of the date the verification is submitted.
Electronic Verification *Acceptable Alternative*	Electronic verification for that period, copy of checks, or bank statements, all showing gross earnings. All authorized deductions must be added back to checks or bank statements to reflect gross amount.
Regular, Unearned Income (e.g., Social Security (SS), SSI, Retirement Funds, Pensions, Annuities, Disability or Death Benefits) (except deferred periodic payments) *Preferred Source*	The adult household member must provide a copy of the most recent award or benefit letter prepared by the authorizing agency. If the date of the letter is not within the last 12 months, require the borrower to submit information updating the award, for example, a cost-of-living (COLA) payment notice, Social Security Benefits Statement, or a notice of change in benefits. Appendix 2 provides sample formats for requesting this information.
Acceptable Alternative	Copies of SS or SSI checks, bank statements, or copy of SS Form 1099 or prior year's award letter plus COLA. If copies of SS or SSI checks or bank statements are provided, Medicare deductions must be added in. If the SSI income fluctuates, the household member must provide award letter stating historical amounts for previous six months.

Type of Income or Verification Source	**Verification Requirements and Procedures**
SUPPLEMENTAL VERIFICATION	
Alimony or Child Support Payments *Preferred Source*	The borrower (or adult household member) **must** obtain a payment history for the last 12 months from the court appointed entity responsible for handling payments. The average amount received will be used in the income calculations.
Divorce Decree *Acceptable Alternative*	If there is not a court appointed entity responsible for handling payments, the adult household member may provide a copy of the divorce decree, separation agreement, or other document indicating the amount of the required support payments. If the borrower reports that the amount required by the agreement is not being received, the borrower must provide adequate documentation of the amount being received (i.e. copies of the checks or money orders from the payer, etc.) and certify the payments are being received or not received.
Cancelled Checks *Acceptable Alternative*	If there is not a court appointed entity responsible for handling payments and formal documents were never issued, support payment can be certified as being received or not received.
Support for Foster Children or Adults *Preferred Source*	Payments received for the care of foster children or foster adults may be considered when calculating repayment income. Documentation must be provided indicating the amount of money received for the care of foster children or adults, and the anticipated period of time the support will be provided. Appendix 2 provides a sample format for requesting information.
Verification of Assets and Income from Assets and Investments *Preferred Source*	For some assets such as mutual funds or 401(k) accounts, copies of year-end statements can provide information about annual income.
Acceptable Alternative	The two most recent bank statements showing the income from investments must be provided; or Electronic printouts of Federal tax forms & schedules clearly identifying income from interest, dividends & capital gains.

Type of Expense or Verification Source	Verification Requirements and Procedures
DEDUCTIONS	
Disability Assistance Expenses *Preferred Source*	To qualify for disability deductions, the borrower must describe the nature of the expense, provide documentation of the costs, and demonstrate that the expense enables a family member to work. *Form RD 1944-4, Certification of Disability or Handicap* should be used to verify the disability.
Acceptable Alternative	Completed and signed *Form RD 3550-21.*
Medical Expenses *Preferred Sources*	For elderly households only, allowable medical expenses may be deducted from annual income. Therefore, documentation of medical expenses is not generally required for non-elderly households. However, non-elderly households with un-reimbursed medical expenses in excess of 3 percent of annual income may receive an exception to the asset limitations. In such cases, these medical expenses must be verified as well. Appendix 2 provides a sample format for documenting medical expenses.
Acceptable Alternative	Completed and signed *Form RD 3550-21.*
Child-Care Expenses	Reasonable child-care expenses may be deducted from annual income. To qualify for the deduction, the borrower must: • Identify the children receiving the child care and the family member who can work or go to school as a result of the care; • Demonstrate there is no adult household member available to care for the children; • Identify the child care provider, hours of care provided, and costs (e.g., letter on the child care provider's letterhead or a copy of a signed child care contract); and • Identify the educational institution and provide documentation of enrollment (if appropriate). Appendix 2 provides a sample format for requesting child-care information.
Acceptable Alternative	Completed and signed *Form RD 3550-21.*

F. Projecting Expected Income for the Next 12 Months

Once an income source is verified, the Loan Servicer must project the expected income from this source for the next 12 months. This projection should be based on a comparison and analysis of the figures derived from using all applicable calculation methods. To establish earning trends and avoid underestimating income (especially from overtime); the more methods used the better. However, some income sources will only lend themselves to one method. The four calculation methods are:

1. Straight-based where the benefit or wage amount is converted to the annual equivalent. Income that may not last for a full 12 months should be calculated using a full 12 months projection, including any verified projected increases.

2. Average where the income as reported on the benefit statements or pay stubs for the last 30 days is averaged and then converted to the annual equivalent.

3. Year-to-date (YTD) where the YTD gross earnings are divided by the number of days worked then multiplied by 365. **This method can only be used if the person receiving the income has continuously worked for the same employer or received the benefit since January 1st and the reported YTD income is for a period ending after March 1st.**

4. Historical where the income as reported on the previous year's tax return is used.

After the Loan Servicer determines the suitable methods and performs the calculations, he/she must determine which figure is most representative of income likely to be received during the next 12 months. If the figures are disparate and one figure is not clearly the most representative, an average of the resulting figures may be used. Conservatively selecting the lowest figure without analysis is not acceptable. The selection must be carefully deliberated and may require additional verification.

Example - Projecting Expected Income for the Next 12 Months

Ken Anderson has worked for B & N Auto for the last two years. According to the verification of employment, Mr. Anderson earns $10/hour, works 40 hours per week, and is expected to work 25 hours of overtime in the next 12 months. Since Mr. Anderson is paid weekly, he submitted his last four pay stubs through the pay period ending February 20th that show gross pay (including overtime) of $407.50, $415, $407.50, and $437.50.
Mr. Anderson's tax return for last year showed gross wages of $22,100.

Straight-based:	Base pay: $10/hour x 40 hours/week x 52 weeks/year = $20,800
	Overtime: $15/hour x 25 hours/year = $375
	Total wages: $21,175
Average:	($407.50 + $415.00 + $407.50 + $437.50) / 4) x 52 weeks/year = $21,678
YTD:	Not appropriate since the ending pay period is before March 1st.
Historical:	$22,100

The earning trend as supported by the average and historical calculations is that overtime is continuously earned at a rate greater than reported on the verification of employment. The Loan Servicer could use the historical figure of $22,100 provided the employer confirms that last year was not an anomaly or they could take an average of the resulting figures. Clearly the Loan Servicer should not use the straight-based figure of $21,175 unless additional documentation is obtained confirming that overtime will be reduced**.**

On August 30th, Mr. Anderson came to the office to say he had found a home to purchase and reported a new baby had increased the size of his family. He would like to have a review to see if his estimated house payment could be lowered. The current pay stub showed $400.00 gross wages with no overtime identified and year-to-date earnings of $16,773. A new verification of employment completed by Mr. Anderson's employer, B & N Auto, showed an hourly wage of $10 and the same projection of 25 hours overtime for the next year.

Straight-based:	Base Pay: $10/hour x 40 hours/week x 52 weeks/year = $20,800
	Overtime: $15/hour x 25 hours/year = $375
	Total Wages: $21,175
YTD:	$25,299 (Based on YTD Calculation Sheet)
Historical:	$22,100

Based on the new Verification of Employment completed by the employer, the year-to-date figure of $25,299 should be used to project the income for the next 12 months.

NOTE: These calculations will be documented in writing and included in the case file. A web based work sheet is available at: **http://incomecalc.sc.egov.usda.gov/**

G. **Income of Temporarily Absent Family Members**

Household members may be temporarily absent from the household for a variety of reasons, such as temporary employment or students who live away from home during the school year. The income of these household members is considered when computing annual income and, if the person is a party to the note, for repayment income.

If an absent person is not considered a member of the household and is not a party to the note, income attributable to the person should not be counted, and the person should not be considered when determining deductions for adjusted income and determining which income limit to use.

Examples - Temporarily Absent Family Member

James Brown and his wife have applied for a loan. At the moment, James is working on a construction job on the other side of the State and comes home every other weekend. He earns $600/week and uses approximately one-third of that amount for temporary living expenses. The full amount of the income earned would be counted for both repayment and annual income.

Adam Watson works as an accountant. However, he suffers from a disability that periodically requires lengthy stays at a rehabilitation center. When he is confined to the rehabilitation center, he receives disability payments equaling 80% of his usual income. During the time he is not in the unit, he will continue to be considered a family member. Even though he is not currently in the unit, his total disability income will be counted as part of the family's annual income.

Desirae Bitz accepts temporary employment in another location and needs a portion of her income to cover living expenses in the new location. The full amount of the income must be included in annual income.

Terri Glass is on active military duty. <u>Her permanent residence</u> is her parents' home where her husband and children live. Terri is not currently exposed to hostile fire. Therefore, because her spouse and children are in the parents' home, her military pay must be included in annual income. (<u>If her spouse or dependents were not in the parent's home</u>, she would not be

H. **Wage Matching**

In States where the Agency has the legal authority to do wage matching, the Loan Originator will use wage matching to verify income for 5 percent of those households that receive *Form 1944-59, Certificate of Eligibility*. The wage matching request should include all adult members of the household, whether or not they have reported taxable income. If the State does not have sufficient resources to conduct all required wage matching, the State Director should request that the Deputy Administrator, Single Family Housing, authorize a lower percentage.

If the wage matching information does not correspond closely with the income reported by the household, the Loan Originator/Servicer should discuss the discrepancies with the applicant and adjust the household's income, as appropriate.

4.9 Calculating ANNUAL AND ADJUSTED Income *[7 CFR 3550.54 (b) AND (c)]*

Annual income is used as a base for computing adjusted income. Income of all household members, not just parties to the note, should be considered when computing annual income. Adjusted income is used to determine eligibility for the amount of payment subsidies under Section 502 Programs.

A. Calculating Deductions from Annual Income

Adjusted income is calculated by subtracting from annual income any of five deductions that apply to the household. Not all households are eligible for all deductions. Exhibit 4-6 summarizes these deductions. The remainder of this paragraph provides guidance on determining whether a family is eligible for each deduction and verifying and calculating these amounts.

Exhibit 4-6
Allowable Deductions from Annual Income

Deduction	Elderly Households	Non-elderly Households
Dependent Deduction	Yes	Yes
Child Care Expenses	Yes	Yes
Elderly Household	Yes	No
Medical Expenses	Yes	No
Disability Assistance	Yes	Yes

B. Dependent Deduction

A deduction from annual income of $480 is made for each household member who qualifies as a dependent. Dependents are members of the household who are not the borrower, co-borrower, or spouse, and who are age 17 or younger, an individual with a disability, or a full-time student. The borrower, co-borrower, spouse or non-spouse of borrower (even if the household member is temporarily absent) may never qualify as a dependent. A foster child, an unborn child, a child who has not yet joined the family, or a live-in aide may never be counted as a dependent.

If more than one family shares custody of a child, the family with primary custody can claim the dependent deduction for that child. If there is a dispute about which family should claim the dependent deduction, the family should provide copies or court orders or tax returns showing which family has claimed the child for income tax purposes.

C. Child Care Expenses

Reasonable unreimbursed child care expenses for the care of children age 12 and under are deducted from annual income if: (1) the care enables a household member to work, actively seek employment, or go to school; (2) no other adult household member is available to care for the children; and (3) in the case of child care that enables a household member to work, the expenses deducted do not exceed the income earned by that household member. If the child care provider is a household member, the cost of the children's care cannot be deducted.

Childcare attributable to the work of a full-time student (except for borrower, co-borrower, spouse, or non-spouse of borrower) is limited to not more than $480, since employment income of full-time students in excess of $480 is not counted in the annual income calculation. Childcare payments on behalf of a minor who is not living in the household cannot be deducted.

To qualify for the deduction, the borrower must:

- Identify the children who are receiving child care and the family member who can work, seek employment or go to school (academic or vocational) as a result of the care;
- Demonstrate there is no adult household member available to care for the children during the hours care is needed;
- Identify the child care provider, the hours of child care provided, and costs;
- Verify the expense is not reimbursed by an agency or individual outside the family; and
- If the expenses enable a family member to go to school, identify the educational institution. The family member need not be a full-time student.

Verification of Child Care Expenses

Childcare hours must parallel the hours the family member works or goes to school. Appendix 2 provides a sample format borrowers can use to document childcare. Other acceptable formats include a letter on the childcare provider's letterhead or a copy of a signed childcare contract.

Example – Child Care Expense Not Counted

Joshua Gladson pays $200 per month in child support. It is garnished from his monthly wages of $1000. After the child support is deducted from his salary, he receives $800. The full monthly salary of $1000 must be counted as income.

Examples – Child Care Deduction
Separate Expenses for Time at Work and Time at School

Lou and Bryce have two children. Both parents work, but Lou works only part-time and goes to school half-time. She pays $4 an hour for eight hours of childcare a day. For four of those hours, she is at work; for four of them she attends school. She receives no reimbursement for her childcare expense.

Her annual expense for childcare during the hours she works is $4,000 and at school is $4,000. She earns $6,000 a year. Bryce earns $18,000.
Lou's childcare expense while she is working cannot exceed the amount she is earning while at work. In this case, that is not a problem. Lou earns $6,000 during the time she is paying $4,000. Therefore, her deduction for the hours while she is working is $4,000.
Lou's expense while she is at school is not compared to her earnings. Her expense during those hours is $4,000 and her deduction for those hours will also be $4,000.
Lou's total childcare deduction is $8,000 ($4,000 + $4,000). The total deduction exceeds the amount of Lou's total earnings, but the amount she pays during the hours she works does not exceed her earnings. If Lou's child care costs for the hours she worked were greater than her earnings, she would not be able to deduct all of her childcare costs.

D. Elderly Household Deduction

A single $400 deduction is subtracted from annual income for any elderly household. To be considered an elderly household, a party to the note must be 62 years of age or older or an individual with a disability. Because this is a "family deduction," each household receives only one deduction, even if more than one member is elderly or disabled.

In the case of a family where the deceased borrower or spouse was at least 62 years old or an individual with disabilities, the surviving household shall continue to be classified as an "elderly household" for the purposes of determining adjusted income if:

- At the time of death of the deceased family member, the dwelling was financed by the Agency;
- The surviving household member occupied the dwelling with the deceased family member at the time of death; and
- The surviving spouse (if any) has not remarried.

E. Deduction for Disability Assistance Expense

Families are entitled to a deduction for un-reimbursed, anticipated costs for attendant care and “auxiliary apparatus” for each family member who is a person with disabilities, to the extent these expenses are reasonable and necessary to enable the person with disabilities or any household member 18 years of age or older to be employed. The borrower must describe the nature of the expense, provide documentation of the costs, and demonstrate that the expense enables a family member to work. Reasonable documented expenses for care of the individual with disabilities in excess of 3 percent of annual income may be deducted from annual income if the expenses:

- Enable the individual with disabilities or another household member to work;
- Are not reimbursable from insurance or any other source; and
- Do not exceed the amount of earned income included in annual income by the person who is able to work as a result of the expenses. If the disability assistance enables more than one person to be employed, the combined incomes of all persons must be included.

To qualify for this deduction, borrowers must identify the individual with a disability on *Form RD 3550-21, Payment Subsidy Renewal Certification*. *Form RD 1944-4, Certification of Disability or Handicap* should be used to request verification of the individual’s disability from a physician or other medical professional.

Example – Eligible Disability Assistance Expenses

The payments made on a motorized wheelchair for the 42-year-old son of the borrower enable the son to leave the house and go to work each day on his own. Prior to purchase of the motorized wheelchair, the son was unable to make the commute to work. These payments are an eligible disability assistance expense.

NOTE: Auxiliary apparatus includes, but is not limited to, items such as wheelchairs, ramps, adaptations to vehicles, or special equipment to enable a sight-impaired person to read or type, but only if these items are directly related to permitting the disabled person or other family member to work. If the apparatus is <u>not</u> used exclusively by the person with a disability, the total cost must be prorated to allow a specific amount for disability assistance.

- Include payments on a specially-equipped van to the extent they exceed the payments that would be required on a car purchased for transportation of a person who does not have a disability.
- The cost of maintenance and upkeep of an auxiliary apparatus is considered a disability assistance expense (e.g., veterinarian and food costs of a service animal and cost of maintaining equipment that is added to a car, but not the cost of maintaining the car).

Payments to a care attendant to stay with a disabled 16-year-old child allow the child's mother to go to work every day. These payments are an eligible disability assistance expense. When the same provider takes care of children and a disabled person over age 12, prorate the total cost and allocate a specific cost to attendant care. The sum of both child care and disability assistance expenses cannot exceed the employment income of the family member enabled to work.

NOTE: Attendant care includes, but is not limited to, expenses for home medical care, nursing services, housekeeping and errand services, interpreters for hearing-impaired, and readers for persons with visual disabilities.

Example – Calculating a Deduction for Disability Assistance Expenses

Borrower earned income	$14,500	
Co-Borrower earned income	+$12,700	
Total Income	$27,200	
Care expenses for disabled 15-year-old	$ 3,850	
Calculation:	$ 3,850	
(3% of annual income)	-$ 816	
Allowable disability assistance expenses		$ 3,034

(NOTE: $3,034 is not greater than amount earned by co-borrower, who is enabled to work.)

F. Deduction for Medical Expenses (for Elderly Households Only)

Medical expenses may be deducted from annual income for elderly households if the expenses: (1) will not be reimbursed by insurance or another source; and (2) when combined with any disability assistance expenses are in excess of 3 percent of annual income.

If the household qualifies for the medical expenses deduction, expenses of the entire family are considered. For example, if a household included the head (grandmother, age 64), her son (age 37), and her granddaughter (age 6), the medical expenses of all three family members would be considered.

Examples - Typical Medical Expenses

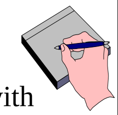
- Services of physicians, nurses, dentists, opticians, chiropractors, and other health care providers
- Services of hospitals, laboratories, clinics, and other health care facilities
- Medical, Medicaid and long-term care premiums, and expenses to HMO
- Prescription and nonprescription medicine prescribed by a physician
- Dental expenses, x-rays, fillings, braces, extractions, and dentures
- Eyeglasses, contact lenses, and eye examinations
- Medical or health products or apparatus (hearing aids, batteries, wheel chairs, etc.)
- Attendant care or periodic medical care (visiting nurses or assistance animal and its upkeep)
- Periodic scheduled payments on accumulated medical bills
- Travel expense and lodging for medical treatment

Examples – Excluded Medical Expenses

- Unnecessary cosmetic surgery to improve the patient’s appearance such as face lifts, hair transplants/removal, and liposuction
- Health Club or YMCA dues, steam baths for general health or to relieve physical or mental discomfort not related to a particular medical condition
- Household help even if recommended by a doctor
- Medical savings account (MSA)
- Nutritional and herbal supplements, vitamins, and “natural medicines” unless these can be obtained legally only with a physician’s prescription
- Non-prescription drugs unless prescribed by a physician for a particular medical condition
- Personal use items unless it is used primarily to prevent or alleviate a physical or mental defect or illness

One of the most challenging aspects of determining allowable medical expenses is estimating a household's medical expenses for the coming year. While some anticipated expenses can be documented easily (for example, Medicare or other health insurance premiums and ongoing prescriptions), others need to be estimated. The Loan Servicer should use historical information about medical bills to estimate future expenses. However, the estimates should be realistic. For example, if the household has a significant medical bill, the Loan Servicer would count only that portion of the bill that is likely to be paid during the coming year.

Example - Calculating the Medical Expense Deduction



The Jensons are an elderly household with annual income of $25,000 and anticipated medical expenses of $3,000 that are not covered by insurance or another source. The allowable medical expenses would be:

Total Medical Expenses	$ 3,000
(less) 3% Annual Income ($25,000 x 0.03)	- 750
Allowable Medical Expenses	$2,250

Example – Medical Expense Paid over a Period of Time

Chynna Ray and Justin Grog did not have insurance to cover Justin's operation four years ago. They have been paying $105 a month toward the $5,040 debt. Each year that amount ($105 x 12 months or $1,260) has been included in total medical expenses. A review of their file indicates that a total of $5,040 has been added to total medical expenses over the four-year period. Over the four-year period they have missed five payments and still owe $525. Although they still owe this amount, the bill cannot be included in their current medical expenses because the expense has already been deducted.

NOTE: For the calculation of assets discussed in Paragraph 4.11, all households are eligible for consideration of medical expenses, not just elderly households.

4.10 Calculating Repayment Income

Repayment income is the amount of household income available to repay the Agency's debt. To compute repayment income, the Loan Servicer should count only the income of persons who will be parties to the note.

The Standard PITI and TD ratio limitations are based on an assumption that borrower income is taxable. If a particular source of income is not subject to Federal taxes, for example, certain types of disability payments or military allowances, the amount of continuing tax savings attributable to the nontaxable income source will be added to the applicant's repayment income. Nontaxable income, such as Housing Choice Vouchers, social security, and child support (provided it is stable and is expected to continue for at least two years), will be multiplied by 120 percent to "gross up" such income.

Example – "Grossing Up" Nontaxable Income

The borrower's repayment income of $22,000 includes $5,000 of nontaxable income. The revised repayment income for the borrower would be calculated as follows:

$17,000	Taxable income
+ 6,000	"Grossed-Up" Nontaxable Income ($5,000 x 1.2)
$23,000	Revised Repayment

4.11 Calculating Income from Assets

During the loan origination process, borrower assets are assessed to determine whether the borrower will be required to make a cash contribution. **After loan origination, only income from assets identified on the borrower's most recent income tax return will be used to determine income for borrowers requesting new or renewed payment subsidy.** Borrowers selected for in-depth quality control reviews will be required to provide sufficient information about household assets to enable the Loan Servicer to complete the review. Form RD 1944-62, *Request for Verification of Deposit,* provides basic information and two certification forms, Verification of Pensions and Annuities, and Certification of Disposition of Assets, can provide additional information about the borrower's assets. For the purpose of computing annual income, the income from assets of all household members is considered. Exhibit 4-7 provides types of assets which are/are not considered in annual income.

Example – Assets that are Part of an Active Business

Megan and Tylar Wasson own a copier and courier service. None of the equipment that they use in their business is counted as an asset (e.g., the copiers, the FAX machines, the bicycles).

Exhibit 4-7
Types of Assets

The following types of assets must be considered.
Non-retirement assets including:

- Savings accounts; the average 2-month balance of checking accounts; safe deposit boxes and home;
- Stocks, bonds, Treasury bills, savings certificates, money market funds, and other investment accounts;
- Equity in real property or other capital investments;
- Revocable trust funds that are available to the household;
- Lump-sum receipts, such as inheritances, capital gains, lottery winnings and settlement on insurance claims (including health and accident insurance, worker's compensation, and personal or property losses);
- Assets held in foreign countries;
- Personal property (such as jewelry, coin collection or antique cars) held as an investment; and
- Cash value of life insurance policies.

Retirement assets including:

- Amounts in voluntary retirement plans that can be withdrawn, such as individual retirement accounts (IRAs), 401(K) plans, and Keogh accounts; and
- Amounts in other retirement and pension plans that can be withdrawn without retiring or terminating employment.

The following types of assets are not considered.

- The value of necessary items of personal property, such as furniture, clothing, cars, wedding rings and other jewelry not held as an investment, and vehicles specially equipped for persons with disabilities;
- Assets that are part of any business, trade, or farming operation in which any member of the household is actively engaged;
- The value of an irrevocable trust fund, or the value of any trust over which no member of the household has control;
- Term life insurance policies where there is no cash value;
- Interests in American Indian trust land; and
- For income calculations, any assets on hand that will be used to reduce the amount of loan.

Example – Withdrawals from IRAs or 401K Accounts

Jim Dunn retired recently. He has an IRA account but is not receiving periodic payments from it because his pension is adequate for his routine expenses. However, he has withdrawn $2,000 for a trip with his children. The withdrawal is not a periodic payment and is not counted as income.

Example – Withdrawals from a Keogh Account

Riley Hales has a Keogh account valued at $30,000. When she turns 70 years old, she begins drawing $2,000 a year. Continue to count the account as an asset. Determine the cash value and imputed income from the asset. Do not count the $2,000 she withdraws as income.

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ATTACHMENT 4-A

WORKSHEET FOR COMPUTING INCOME

To access the worksheet and a tutorial on the worksheet, visit the Forms & Resources page for the Single Family Housing Direct Home Loans.

ATTACHMENT 4-B

WORKSHEET FOR COMPUTING INCOME

[RESERVED]