Welcome to the Section 502 Direct Loan and 504 Loan/Grant Programs webinar on Determining Annual, Adjusted, and Repayment Incomes. This session is conducted by the Single Family Housing Direct Loan Division with a revision date of March 7, 2018.

The purpose of this presentation is to give viewers a basic overview of how to determine annual, adjusted, and repayment income for the Single Family Housing Direct Programs (both the Section 502 and Section 504 programs). While this recorded webinar is targeted to Rural Development (RD or Agency) staff, others (such as loan application packagers) may find the information useful.

Income Types

The Single Family Housing Direct Programs consider the following three types of income when processing an application:

ANNUAL INCOME

ADJUSTED INCOME

REPAYMENT INCOME

The 502 and 504 programs consider and use three types of income when processing an application: Annual, Adjusted, and Repayment. Each of these income calculations play an important role when determining if an application is eligible for a particular program. Annual income must be calculated first, as it is the basis for other income calculations which follow.

Worksheets for Computing Income

For the Section 502 program, the worksheet can be found at: https://www.rd.usda.gov/programs-services/single-family-housing-direct-home-loans

For the Section 504 programs, the worksheet can be found at: https://www.rd.usda.gov/programs-services/single-family-housing-repair-loans-grants

Before detailing the three income types, let’s briefly discuss the worksheets for computing income.

For the Section 502 program, the Worksheet for Computing Income and Maximum Loan Amount Calculator (commonly known as the automated 4-A) can be found on the program’s Forms & Resources site; a link to the site is provided on the slide. The site also provides a tutorial that explains how to complete this worksheet.

For the Section 504 programs, the 504 Automated Worksheet can be found on the programs’ Forms & Resources site; a link to the site is provided on the slide.

Worksheets for Computing Income (Continued)

For applications received directly from the applicant, the Loan Originator completes the applicable worksheet for the Loan Approval Official's review.

For a packaged loan, the applicable worksheet should be completed by the packager and submitted to RD with the complete application package. The RD staff then reviews/concurs or revises if necessary.

For applications received directly from the applicant, the Loan Originator completes the applicable worksheet for the Loan Approval Official's review.

For any packaged loan, the applicable worksheet is completed by the packager and submitted to RD with the complete application package. The RD staff then reviews/concurs or revises if necessary. In the event RD staff does not concur with the packager's calculations, a new worksheet is completed by RD and a copy provided to the packager.

In all cases, the applicant case file must contain a copy of the applicable/completed worksheet.

Definition of Annual Income

ANNUAL INCOME is the income of all household members from all sources unless excluded based on the programs' guidance.

A household member is any person who is expected to reside in the home involved with the request for RD assistance; this would include a household member that is temporarily absent. Live-in aids and foster persons (children or adults) are not considered members of the household; and the payments received for the care of foster persons are excluded from the income types.

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The applicant must identify all household members and all sources of household income when completing their application. The applicant must also provide verification of all household income as outlined in the checklist of items to accompany the application (Attachment 3-J for the Section 502 program and Attachment 12-E for the Section 504 programs).

Definition of Annual Income (Continued)

ANNUAL INCOME:

- Generally considers gross income; net income is considered for self-employment and for interest/dividends from real or personal property.
- Excludes (among other things) any earned income of a household member under 18 years of age and any earned income in excess of $480 of a household member who is a full-time student 18 years of age or older. These exclusions do not apply to the applicant or their spouse.

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Common Income Sources

- Wages
- Self-employment
- Interest/dividends from real or personal property
- Social Security benefits (including benefits received by adults on behalf of minors or by minors intended for their own support)
- Periodic payments (e.g. annuities, retirement funds, and disability/death payments)

Income may be received from multiple sources. Handbook-1-3550, Paragraph 4.3 discusses sources of income and specifies whether the sources are considered for annual income, repayment income, both, or none.

Here are the common income sources included in annual income when received by a household member and included in repayment income when received by the applicant.

- **Wages.** This could include wages based on salary, an hourly rate, overtime, bonuses, commissions, tips, housing allowances, and any other income received from an employer. Fringe benefits such as car/mileage allowance, employer provided medical/life insurance, stock options, work expense reimbursement, etc. are typically not included in annual income, unless the employer reports them as taxable income.
- **Self Employment Income**. The net income from the operation of a farm, business, or profession as reported to the Internal Revenue Service (IRS). The form used for the IRS filing may vary depending on the type of business structure. Loan Originators and Loan Approval Officials must analyze the tax filing to determine which business deductions are "allowed". For instance: A business loss reported to the IRS is considered "$0" in determining annual income because a negative

amount cannot be used to offset other family income.

- **Interest Income**. This may include interest, dividends, and other net income from real or personal property such as: shares from income distributed from a trust fund, withdrawal of cash or assets from an investment, etc.
- **Social Security Income**. Include the full amount of the benefit before deductions are taken. When considering annual household income, you would include benefits received by adult members of the household as well as those received by adults on behalf of minors, or by minors intended for their own support. Regular, recurring payments are considered. In the event that an applicant had received a lump sum distribution or benefits, this would not be projected as annual income for the upcoming 12 month period.
- **Periodic payments (e.g. annuities, retirement funds, disability/death benefit payments)**. Any recurring retirement or disability income received on a recurring basis is included in annual income whether it is received monthly, quarterly, or on an annual basis.

Common Income Sources (Continued)

- Payments in lieu of earnings (e.g. unemployment benefits)
- Public assistance
- Child support/alimony
- Recurring monetary gifts
- 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

- **Payments in lieu of earnings**. This may include income sources such as unemployment, disability compensation, worker's compensation, and severance pay. Some sources may be received on a recurring basis while others are received on a one-time basis. Care must be taken to review the source and determine if it is ongoing and should be projected as annual income for the next 12 months. For instance, an applicant who is a farm laborer may work 8 months out of the year and be unemployed for 4. The unemployment benefits in that situation are typical and would be projected as annual income. However, in the case of an applicant who was laid off last year, received unemployment benefits for 4 months while looking for a job and is now back in a full time position – that income would not be considered in annual because it is not anticipated to be received.
- **Public Assistance.** The monthly gross amount received for the household in public assistance is included in annual income.
- **Child Support/Alimony**. Typically, child support and alimony are awarded by the court in a divorce decree, separation agreement, or parenting plan/custody agreement. The amount included in annual income is the amount actually received. For example, if the parenting plan indicates that the applicant should receive $350/month but they have evidence that only $100/month is received and they have attempted to collect amounts due, then only $100 would be counted in

annual income. As another example, if the divorce decree indicated $200/month alimony but the applicant is receiving $500/month due to back payments which were not received and those are anticipated to be received in the next 12 months, then the $500/month would be considered.

- **Recurring Gifts**. This income source does not mean that if the applicant's parents give them $300 for their birthday every year, you would count it in annual income. A better example of a recurring gift payment would be a senior on a fixed income whose child pays his cell phone bill of $100 each month to help him meet expenses. This is an ongoing gift which is not based on wages, public assistance, or a retirement source but is coming from someone outside of the household and is received on a recurring basis.
- **Military/Armed Forces pay**. Include 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 members currently lives in the home. This means that even though the person may be deployed and away from the home, they are considered a household member and this income is counted.

Verifying Income Sources

Handbook-1-3550, Paragraph 4.3 includes a “Preferred Source of Verification” table that outlines the preferred source of verification for the various income sources and the acceptable alternative if the preferred source is unavailable, questionable, insufficient, or cannot be obtained without cost.

The preferred source should be readily available to the applicant; these documents are likely kept by the applicant in their personal records or can be easily obtained by them online.

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The preferred source should be readily available to the applicant; these documents are likely kept by the applicant in their personal records or can be easily obtained by them online.

Let’s go through some examples of the preferred source of verification:

- Wages are verified using copies of not less than four consecutive and recent paycheck stubs or payroll earnings statements; and an oral verification completed by the RD staff to confirm the applicant’s present position and probability of continued employment. Income information should not be discussed during the oral verification.
- Self employment is verified using current documentation of income and expenses as well as the last two Federal income tax returns with the applicable schedules.
- Social Security is verified using a copy of the most recent award letter.

- Child support is verified through a 12-month payment history from the court appointed entity responsible for handling payments.

Regardless of the source of verification used (preferred or acceptable alternative), the information should be compared to other pertinent documents in the case file. For example, the paycheck stubs should be compared to what was reported on the application, the applicant's last two Federal income tax returns, and their bank statements with direct deposits from the employer. Significant discrepancies will need to be addressed.

Verifications are typically valid for 120 days and must be valid at the time of eligibility, loan approval, loan closing, and construction-to-permanent conversions.

Projecting Annual Income

Once the household's income sources have been identified and verified, it is time project the expected incomes for the next 12 months. Each income source should be calculated, compared, and analyzed using all applicable income calculation methods to avoid underestimating or overestimating income.

The four income calculation methods are straight-based, average, year-to-date, and historical.

Once the household's income sources have been identified and verified, it is time project the expected incomes for the next 12 months. Each income source should be calculated, compared, and analyzed using all applicable income calculation methods to avoid underestimating or overestimating income.

Only the income from household members should be included. Live-in aides, foster children and foster adults are not considered household members and their income would not be included in the annual income calculations.

For FULL time students <u>who are not an applicant</u> <u>or the spouse of the applicant</u>, only count the first $480 for annual income.

Income is projected for the next 12 months, using the data collected to verify the income source. If there is known, verifiable evidence that a change will occur, the change must be documented and the income may be excluded. As an example: a household has 3 children and is receiving child support in the amount of $200/month for the oldest child who is 17. When she turns 18 in 4 months, the child support payments will end. In this case, rather than projecting $2,400 in annual child support income for the household, you would calculate $200/month x 4 months for a total projection of $800 for the upcoming year. This reasoning does not apply to most income sources because there is typically not a known, verifiable end date.

When considering seasonal, unemployment and self employment income it is often necessary to analyze what is currently received, as well as historical data. For example, someone who works in construction may typically work 9 months out of the year and receive 3 months unemployment benefits. Using historical data will assist when analyzing trends to determine the projection for that income source.

Once an income source is verified, the Loan Originator must project the expected income from this source for the next 12 months. This should be based on a comparison and analysis, using all applicable calculation methods. There are 4 income calculation methods which we will be discussing: straight-based, average, year-to-date, and historical. To establish earnings and avoid underestimating income, the more methods used the better. When possible and applicable, all 4 methods should be calculated. However, some income sources (for instance social security income) will only lend themselves to one method.

Next we'll define the four income calculation methods and then provide an example of all four methods using an applicant named Dante.

Projecting Annual Income (Continued)

Straight-based involves converting the income to the annual equivalent.

Average involves averaging the income received within the last 30 days and then converting that amount to the annual equivalent.

Year-To-Date (YTD) involves dividing the gross YTD earnings by the applicable YTD interval and then multiplying that amount by 365.

Historical involves using the income as reported on the previous year’s Federal income tax return.

Straight-based involves converting the income to the annual equivalent.

With the straight-based method, the applicant typically has a fixed hourly wage or salary, a fixed or average number of hours worked per week and those fixed amounts are converted into an annual equivalent.

Average involves averaging the income received within the last 30 days and then converting that amount to the annual equivalent.

In other words, if you are reviewing the last 4 weeks of paystubs, you would add the gross income from those paystubs, divide by 4 to obtain the weekly average, then multiply that by 52 weeks to obtain the annual equivalent.

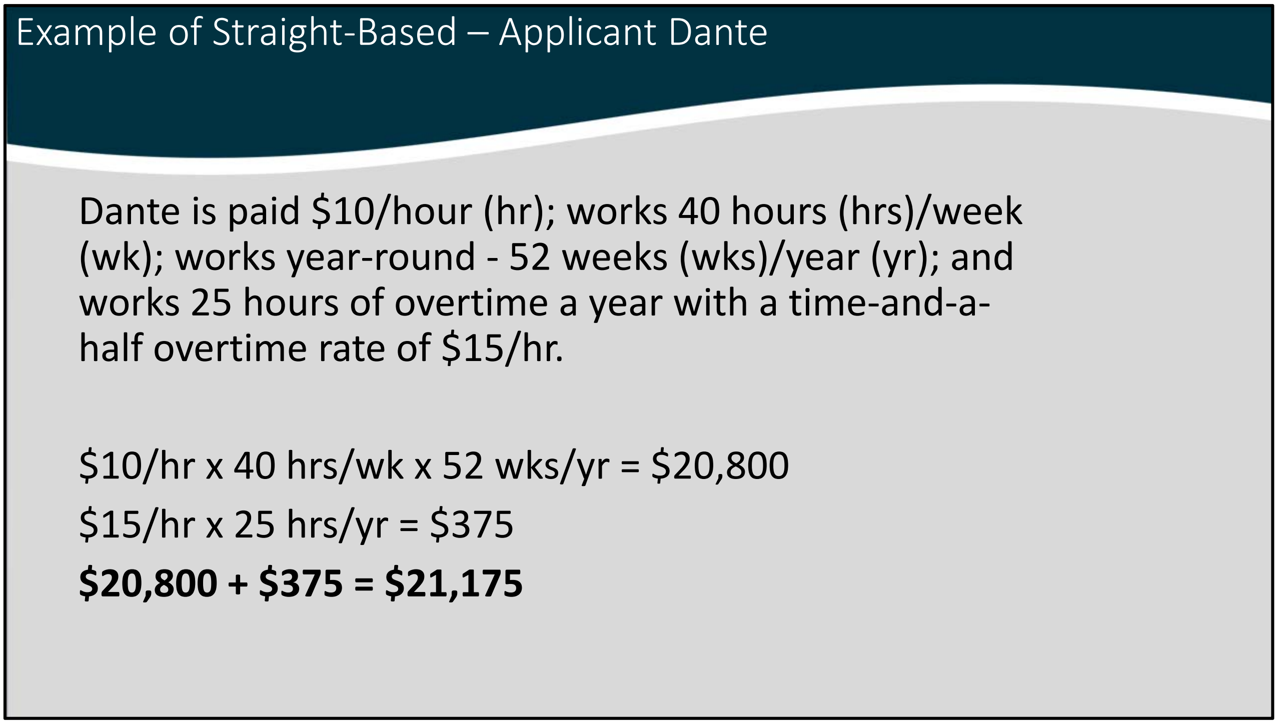
Year-To-Date (YTD) involves dividing the gross YTD earnings by the applicable YTD interval and then multiplying that amount by 365.

Looking at the gross year to date earnings on a paystub (which would include regular wages, overtime, bonus, etc.), divide the total gross earnings by the number of days as reported on the paystub. Care should be taken to verify the "paid through" date as it may vary from the date of the paystub. The amount per day is then multiplied by 365 days to determine the annualized income based on year to date figures.

Historical involves using the income as reported on the previous year's Federal income tax return.

Historical income can be very straightforward. If the applicant has worked for the same employer all year, the amount of the W-2 for that year would be considered the historical income for that employer. However, historical income can also be challenging if the applicant only worked a partial year, or had multiple employers during the year.

Each case will be different and a thorough analysis of the information is important to accurately calculate income.



Dante is paid $10/hour; works 40 hours /week; works year-round - 52 weeks /year; and works 25 hours of overtime a year with a time-and-a-half overtime rate of $15/hr.

Using that information, you would calculate his income for the straight-based method as follows:
Wages: $10/hr x 40 hrs/wk x 52 wks/yr = $20,800
Overtime: $15/hr x 25 hrs/yr = $375

Wages of $20,800 + anticipated overtime of $375 = $21,175 annual income

Using the straight-based method, Dante’s projected annual income totals $21,175.

Example of Average – Applicant Dante

Dante's last four weekly pay stubs reflect a gross income of $430, $415, $430, and $415.

$430 + $415 + $430 + $415 = $1,690

$1,690/4 wks = $422.50/wk

$422.50/wk x 52 wks/yr = $21,970

Dante's last four weekly pay stubs reflect a gross income of $430, $415, $430, and $415.

To determine his weekly average, you would add the 4 together, so:
$430 + $415 + $430 + $415 = $1,690

And then divide the $1,690 total by 4 wks to reach the average weekly income of $422.50/wk

The average amount of $422.50/wk x 52 wks/yr = $21,970

Using the average method, Dante's projected annual income totals $21,970.

Example of YTD – Applicant Dante

Dante’s most recent paystub shows a gross YTD income of $6,640 which covers 16 weeks.

16 weeks x 7 days/wk = 112 days

$6,640 / 112 days = $59.29/day

$59.29/day x 365 days/yr = $21,640.85

The third method is based on year to date income.

In this example, Dante’s most recent paystub for 16 weeks reflects $6,640 in gross income.

While the automated calculator has a feature to help calculate the number of days shown on the paystub, let’s review how to do this by hand.

First, determine the number of days represented by the paystub. 16 weeks x 7 days per week is 112 days. Then, take the gross income as reflected on the paystub and divide it by the number of days. In this example, $6,640 is divided by 112 days, resulting in $59.29/day. Then, to annualize the daily amount, multiply the daily figure of $59.29/day by 365 days. Dante’s annualized income using the YTD method is $21,640.85.

Remember when using this method, care should be taken to verify the “paid through” date as it may vary from the date of the paystub.

Example of Historical – Applicant Dante

Dante’s Federal income tax return indicates that he earned $20,350 from the same employer last year.

Dante’s Federal income tax return indicates that he earned $20,350 from the same employer last year.

Since he had the same employer for the entire year, that amount can be used for his historical income figure.

Example of Comparing the Methods – Applicant Dante

Straight-based:	$21,175
Average:	$21,970
YTD:	$21,640.85
Historical:	$20,350

Which income is accurate?

Why?

What questions should you ask?

Now that we have calculated the income for Dante using the four methods, it is time to analyze the results.

As you can see, none of the income calculations are exactly the same. However, the calculations do show income in a general range. It is the responsibility of the RD staff to project the income in a manner that most represents what the applicant is likely expected to earn in the next 12 months. Because the income methods have different results, you will need to ask additional questions.

Since the historical income is less than the other three methods, you will need to investigate to determine why there is a difference. Potential questions to ask the applicant include:

- Have you received a pay raise since last year?
- Did you work less overtime last year?
- Were you employed for the full year last year?

The other three methods are within $795 of each other and are all within a reasonable range. Selecting either of the three is reasonable and appears to be a likely indication of income to be received in the next 12 months. To determine which is the most accurate, you may need to ask:

- Is overtime earned year round or just during certain periods? For instance, Dante may only work overtime in the first four months of the year, and then doesn't receive overtime for the remainder of the year. Projecting the same rate of overtime for the entire year will overestimate his income.
- Do the number of hours worked per week fluctuate seasonally?

Alternatively - if Dante's prior year's Federal income tax return indicated he earned $30,000, the type of questions asked would be quite different:

- Was there additional overtime last year?
- Did you receive a bonus last year? If so, is that likely to continue this year?
- Were you demoted?
- Have your hours been reduced this year or was there a period of unemployment this year?

Comparing the results of the income calculation methods help identify anomalies which may impact which method is ultimately used for the projection. Considering the methods for Dante above at face value, it appears that historical is the least likely method to use and selecting average or YTD is probably the most reasonable as they are the closest in range. However, asking the questions we discussed may lead you to another decision. Unlike a math test with absolute answers, when projecting income there isn't necessarily a "right" and a "wrong" answer. Two people looking at the same information may project slightly different income amounts. The key point is to calculate all four methods when applicable, ask the appropriate questions, document the applicant's responses, select the income which seems the most likely, and then document your determination.

In this example, if a packager or Loan Originator had recommended to use average income as the basis for the loan, it would be reasonable for the Loan Approval Official to concur with that determination.

Projecting Annual Income – Are all four methods needed?

As previously mentioned, each income source should be calculated, compared, and analyzed using all applicable income calculation methods. All four methods are used only if relevant and reasonable. An income source may only be suitable for one method, two methods, or three methods.

Regardless of the method(s) used, the resulting income must be well documented in the case file.

As previously mentioned, each income source should be calculated, compared, and analyzed using all applicable income calculation methods. All four methods are used only if relevant and reasonable. An income source may only be suitable for one method, two methods, or three methods.

For instance:

- When the applicant has a fixed, monthly income such as social security, the only method necessary to calculate is the straight-based method because there are no fluctuations to the income source and the applicant may not be required to file a tax return.
- Year-to-date income may not accurately reflect seasonal overtime or bonuses. If the applicant receives their bonus every year in October and has significant overtime from October –December but the year to date income is through June, then the YTD will likely not result in an accurate income determination. However, in this case it is still important to calculate the method because those anomalies will likely show up with the resulting annualized income figure and when that figure is compared to the historical, it will lead you to ask questions.
- An applicant may have different types of income. Perhaps they receive a flat salary

of $30,000 per year. The salary won't change, so using the straight-based method is the most accurate determination for the salary income. However, they also receive commission. While it may not be necessary to calculate all 4 methods to determine the salary, it may be necessary to use all 4 methods to determine the commission income.

Regardless of which of the 4 methods is used and ultimately selected, it is critical to document the case file with the information used to reach that decision. Each case should be reviewed based on the information for that applicant.

Conservatively selecting the lowest income projection every time is not acceptable and may result in unauthorized assistance because the applicant receives too much subsidy. On the other hand, over estimating income and always selecting the highest figure could result in a mortgage amount that is beyond the applicant's ability to repay.

Projecting income is rarely an exact science. Comparing the income using the 4 methods, asking additional questions as needed, and analyzing the data are all critical steps to reaching a reasonable projection of income that is likely to occur.

The Importance of Accurately Projecting Annual Income

Overestimating the income projection could lead to a false determination of repayment ability.

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In addition to making loans to qualified applicants, a Loan Approval Official must be concerned with limiting the Agency's risk. Applicants are determined eligible when they demonstrate a reasonable ability and willingness to be a successful homeowner who can make their mortgage payments, maintain the property, and pay their debt obligations. A homeowner who is unable to do this, will likely end up in default on their mortgage payment and become a servicing issue, or risk for the Agency. An over-projection of income potentially means making a loan that the applicant can't afford. On the flip side, underestimating the income means that the applicant will receive more payment assistance than they should have. When their income is reviewed at their first payment assistance renewal, if they have more income than was projected, they may end up with a bill for unauthorized payment assistance which they must then repay.

The next income type that will be discussed is adjusted income.

Definition of Adjusted Income

ADJUSTED INCOME is annual income less the following allowable deductions: Dependent, child care expenses, elderly household, disability assistance, and medical expenses. The conditions for a deduction must be met in order for it to be applied. If no deductions apply, the household's annual income and adjusted income are the same.

Adjusted income is used to determine whether the household is income-eligible for a particular program.

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Adjusted income is used to determine whether the household is income-eligible for a particular program.

To qualify for the Section 502 program, the household's adjusted income cannot exceed the low-income limit for the applicable location and household size. To qualify for the Section 504 programs, the household's adjusted income cannot exceed the very low-income for the applicable location and household size. For the Section 502 program, adjusted income is also used to determine payment assistance.

On the checklist of items to accompany the application, the applicant is asked be provide verification of child care expenses and out of pocket medical expenses if applicable.

Dependent

The deduction for a dependent is $480 per qualified dependent.

A qualified dependent is a household member who is not the applicant or their spouse that is:

- 17 years of age or younger,
- An individual with a disability, or
- A full-time student.

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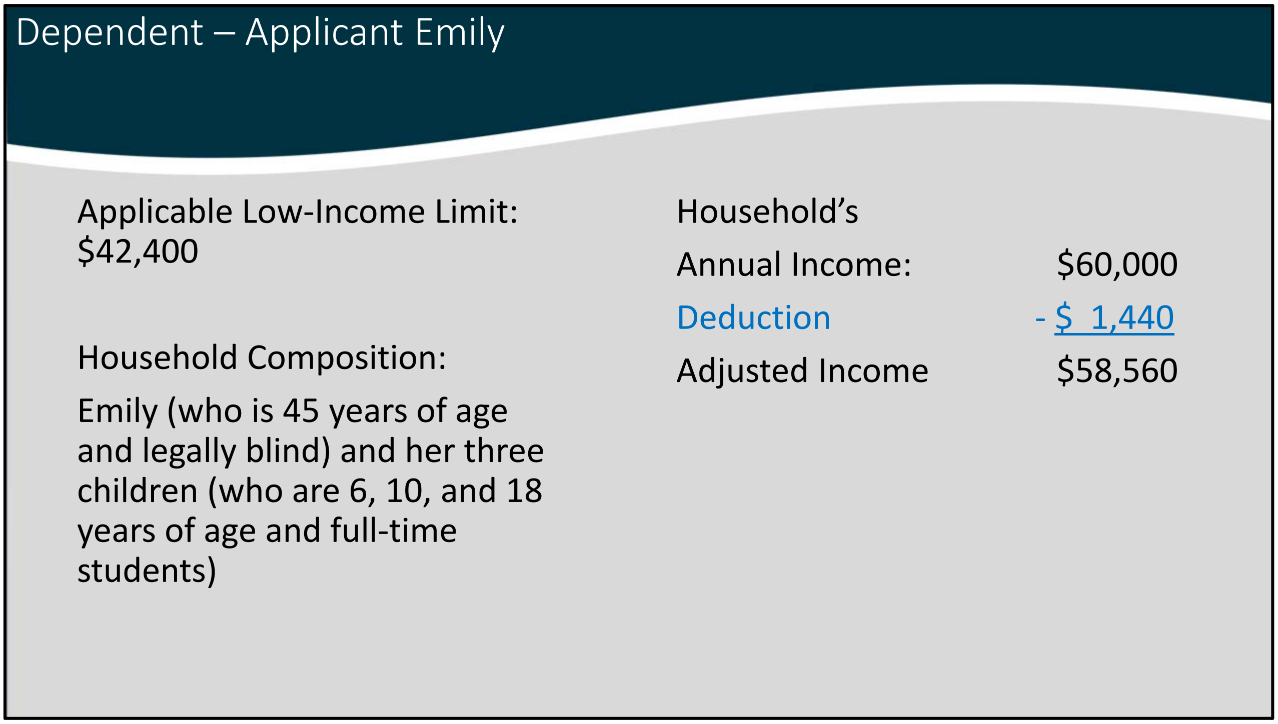
- 17 years of age or younger,
- An individual with a disability, or
- A full-time student.

A foster child, unborn child, or child who has not yet joined the family cannot be counted as a dependent.

The definition of a full-time student may vary from school-to-school. In order to determine if the student is considered full-time, verify that the student is taking the minimum number of credits to be considered full-time at that school/college/university.

To calculate the deduction for the household, simply determine the number of qualified dependents and multiply that number times $480.



To show you the impact of the allowable deductions, let's examine an applicant named Emily who wishes to purchase a modest home through the Section 502 program.

The household's annual income was calculated at $60,000. The applicable low-income limit for this family of four is $42,400. The household is composed of Emily (who is 45 years of age and legally blind) and her three children (who are all full-time students: 6, 10, and 19 years of age).

Let's consider the effect of the dependent deduction on the household income. All three children are qualified dependents (under the age of 18 or a full-time student). None are the spouse of the applicant. Using the standard deduction of $480/child x three children, results in a deduction of $1,440 from the annual income which brings the adjusted income down to $58,560.

While this amount is still over the applicable low-income limit, there are four additional deductions to consider.

Child Care Expenses

Reasonable unreimbursed child care expenses for the care of children age 12 and under can be deducted if:

- The care enables a household member to work, actively seek employment, or go to school;
- No other adult household member is available to care for the children; and
- The expenses deducted do not exceed the income earned by the household member enabled to work. This limitation does not apply if child care allows the household member to go to school or seek employment.

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- The care enables a household member to work, actively seek employment, or go to school;
- No other adult household member is available to care for the children; and
- The expenses deducted do not exceed the income earned by the household member enabled to work. This limitation does not apply if child care allows the household member to go to school or seek employment.

For instance, if child care is being paid for five hours a week in order for the parent to “take a break without the kids”, that expense would not be deductible. However, if the time in daycare coincides with the time spent working, in school, and/or seeking employment (including commute/study times), then the amount paid can be used as a deduction.

Child Care Expenses (Continued)

To qualify for the deduction, the applicant must:

- Identify the children who are receiving the care and the family member who is enabled to work, seek employment, or attend school as a result of the care.
- Demonstrate there is no adult household member to care for the children.
- Identify the child care provider, the hours of care provided, and the costs.
- If the expenses enable a family member to go to school (full or part time), identify the educational institution.

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- Identify the children who are receiving the care and the family member who is enabled to work, seek employment, or attend school as a result of the care.
- Demonstrate there is no adult household member to care for the children.
- Identify the child care provider, the hours of care provided, and the costs.
- If the expenses enable a family member to go to school (full or part time), identify the educational institution.

It is the responsibility of the applicant to provide adequate documentation to support the child care expenses. The application will contain much of this information and is typically supplemented by evidence from the child care provider re: the amount paid (such as a letter or billing statement on the child care provider's letterhead or a copy of the signed contract). Remember that the preferred sources of verification should be from items readily available to the applicant such as a billing statement, cancelled checks, etc. If these items are not available, then a verification form may be sent to the provider to verify the costs.

Child Care Expenses – Applicant Emily

Applicable Low-Income Limit: $42,400

Household Composition:

Emily (who is 45 years of age and legally blind) and her three children (who are 6, 10, and 18 years of age and full-time students)

Household's Annual Income	$60,000
Dependent	- $ 1,440
Child Care Expenses	- $ 6,000
Adjusted Income	$52,560

Emily pays $500/month in child care expenses for her two youngest children which enables her to work full-time; the amount is fixed for the next 12 months. While Emily's eldest child is considered an adult, he is a full-time student so he is not available to care for his siblings. Through the verification process, it is determined that Emily's child care expenses are not reimbursed by an outside source (such as a state agency or her employer).

After also subtracting the allowable child care expenses deduction of $6,000 from the annual income - the adjusted income is reduced to $58,560. While this amount is still over the applicable low-income limit, there are three additional deductions to consider.

Quick general note: Child care expenses often differ during the school year vs. the summer. Lower during the school year and higher during the summer. Through the verification process, the provider is asked to provide the average amount charged and the expected cost during the next 12 months.

Elderly Household

The deduction for an elderly household is $400.

A household is classified as an elderly household when the applicant is 62 years of age or older or an individual with a disability.

Only one $400 deduction is permitted even if the application consists of multiple applicants that meet the above conditions

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Only one $400 deduction is permitted even if the application consists of multiple applicants that meet the above conditions.

Elderly Household – Applicant Emily

Applicable Low-Income Limit: $42,400

Household Composition:

Emily (who is 45 years of age and legally blind) and her three children (who are 6, 10, and 18 years of age and full-time students)

Household's Annual Income	$60,000
Dependent	- $ 1,440
Child Care Expenses	- $ 6,000
Elderly Household	- $ 400
Adjusted Income	$52,160

Using the same example for our applicant Emily, let's consider the elderly household deduction for the application. Based on the information stated in the slide, it is clear that the applicant does not qualify for the deduction based on age, but in reviewing page 6 of the 410-4 application, the applicant indicated that they wanted to be considered for an adjustment from household income because of a disabling condition. In this case, the applicant told you that she is legally blind. Because the deduction is granted for an applicant 62 years or older, or an individual with a disability, the "elderly household" deduction is allowed for this applicant.

Unlike the dependent deduction which is multiplied by the number of dependent children, the elderly household deduction is a one time, household deduction of $400.

In our case study, the applicant does work full time, but notifies you that she is legally blind. Because she is an individual with a disability, she qualifies for the one time deduction of $400. When combined with the dependent and child care deductions, the adjusted income is now $52,160 which is still over the low income limit of $42,400 for this household.

Disability Assistance Expenses

To qualify for the deduction, the applicant must identify any household member with a disability on the application, describe the nature of unreimbursed expenses for that household member's attendant care/auxiliary apparatuses, provide documentation of the expenses, and demonstrate that the expenses enable an adult household member (with or without the disability) to work. Reasonable expenses in excess of 3% of the household's annual income can be deducted provided the expenses don't exceed the amount earned by the person enabled to work.

To qualify for the deduction, the applicant must identify any household member with a disability on the application, describe the nature of unreimbursed expenses for that household member's attendant care/auxiliary apparatuses, provide documentation of the expenses, and demonstrate that the expenses enable an adult household member (with or without the disability) to work. Reasonable expenses in excess of 3% of the household's annual income can be deducted provided the expenses don't exceed the amount earned by the person enabled to work.

If the household member receives a form of income as a result of a verified disability (such as social security disability or disability compensation), that may be used as a method to verify the disability. Otherwise, the Form RD 1944-4, Certification of Disability or Handicap, should be used to have a physical or other medical professional verify the household member's disability.

Disability Assistance Expenses (Continued)

Examples of eligible unreimbursed disability assistance expenses include:

- Home medical care and nursing services.
- Housekeeping and errand services.
- Interpreters for hearing-impaired.
- Wheelchairs, ramps, and adaptations to vehicles.
- Special equipment to enable a sight-impaired person to read or type.

There are many expenses which can be considered for the disability assistance expenses deduction. Examples include but are not limited to:

- Home medical care and nursing services.
- Housekeeping and errand services.
- Interpreters for hearing-impaired.
- Wheelchairs, ramps, and adaptations to vehicles.
- Special equipment to enable a sight-impaired person to read or type.

The costs may be associated with the applicant to assist them to work. Or, it may be for the care of a household member which allows the applicant to work. Similar to the daycare deduction, this deduction cannot exceed the amount of earned income included in the annual income for the person who is able to work as a result of the expense. The cost as well as the maintenance of auxiliary apparatus can be included. The key factor is determining what items are recurring so that you can project the next 12 months' expenses.

Disability Assistance Expenses – Applicant Emily

3% of the household's annual income ($60,000) is $1,800.

Unreimbursed expenses over this amount that meet the qualification requirements can be used as a deduction. Emily's total allowable expenses equals $4,100 so her allowable disability assistance expenses deduction is $2,300.

Total allowable expenses	$4,100
Minus 3% of annual income	<u>$1,800</u>
Equals allowable deduction	$2,300

Let's consider the disability assistance expenses for Emily.

In order to get to work, Emily has a seeing eye dog who assists her with navigating public transportation and the walk to the office. She also uses a white cane. Each month, she pays $300 for ongoing training/care of the dog and the white cane costs $50 each time she replaces it (which is typically annually). Her total ongoing annual expenses are $4,100. The expenses enable her to work because without it, she would be unable to get to her office.

The first step is to calculate 3% of the household's annual income by multiplying the annual income of $60,000 x 3%, which equals $1,800.

Only the unreimbursed expenses over $1,800, that meet the qualification requirements can be used as a deduction. Emily's total allowable expenses equals $4,100. Once the $1,800 is deducted, her allowable disability assistance expenses deduction is $2,300

Disability Assistance Expenses Deduction – Applicant Emily

Applicable Low-Income Limit: $42,400

Household Composition:

Emily (who is 45 years of age and legally blind) and her three children (who are 6, 10, and 18 years of age and full-time students)

Household's Annual Income	$60,000
Dependent	- $ 1,440
Child Care Expenses	- $ 6,000
Elderly Household	- $ 400
Disability Assistance Expenses	- $ 2,300
Adjusted Income	$49,860

Back to Emily's adjusted income calculations – by taking the disability expense deduction of $2,300, Emily's adjusted annual income is now $49,860.

While this amount is still over the applicable low-income limit, there is one additional deduction to consider.

Medical Expenses

For elderly households ONLY, unreimbursed medical expenses for the entire household may be deducted from annual income if the expenses (when combined with any disability assistance expenses) are in excess of 3% of the households annual income.

Recall that a household is classified as an elderly household when the applicant is 62 years of age or older or an individual with a disability.

Expenses are anticipated and projected for the next 12 months.

For elderly households ONLY, unreimbursed medical expenses for the entire household may be deducted from annual income if the expenses (when combined with any disability assistance expenses) are in excess of 3% of the households annual income.

Recall that a household is classified as an elderly household when the applicant is 62 years of age or older or an individual with a disability.

Expenses are anticipated and projected for the next 12 months.

Unlike the disability assistance expenses which are calculated only for the person or persons with the disability, when the elderly household qualifies for the medical expense deduction, then the expenses of the **ENTIRE FAMILY** (all medical bills for the household - are considered). Much like the other expenses we have considered, the expenses cannot be reimbursable from another source.

Medical Expenses (Continued)

Examples of eligible unreimbursed medical expenses include:
- Services of physicians and health care facilities.
- Medical, Medicare, and long-term care premiums.
- Medicine prescribed by a physician.
- Dental expenses.
- Eyeglasses, contact lenses, and eye exams.
- Medical/health products or apparatus.
- Attendant care.

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- Services of physicians and health care facilities.
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- Dental expenses.
- Eyeglasses, contact lenses, and eye exams.
- Medical/health products or apparatus.
- Attendant care.

Handbook-1-3550, Chapter 4 contains a comprehensive listing of typical medical expenses which can be considered for the medical deduction. Expenses should be verified from third party sources such as billing statements. However, in acknowledgment of medical privacy laws, the applicant need not disclose the specific medical condition/prescription to qualify.

Remember that if the elderly household qualifies for the deduction, medical expenses of the **ENTIRE FAMILY** are considered.

Because income is always being projected for the next 12 months, it is important to consider what the actual medical expenses are for the upcoming 12 months. For instance, if a household member had a surgery which cost $10,000 last year – you would not likely include that as an expense for the next 12 months unless it was a surgery that needed to be performed every year and they paid the full amount every year. However, if the applicant had agreed to pay $150 a month to the Dr. to pay for a surgery and the balance due reflects that those will continue to be paid in the next 12 months, then you could include the $150/month payments because they are projected to continue for the next 12 months.

Medical Expenses – Applicant Emily

Unreimbursed medical expenses for the entire household:

Health insurance premiums $450/mo x 12	= $5,400
Dr. payments for surgery $150/mo x 12	= $1,800
Dental co-payments $75 x 4 household members	
x 2 times / year (every 6 months)	= $ 600
Payments for braces (18 yr old) $75/mo x 12	= $ 900
Eyeglasses – 1 pair/yr	= $ 300
Monthly prescription co-payments $44 x 12	= $ 540
Total	= $9,540

Unreimbursed medical expenses for the entire household for Emily are as follows:

Health insurance premiums $450/mo x 12 mo	= $5,400
Dr. payments for surgery $150/mo x 12 mo	= $1,800
Dental co-payments $75 x 4 household members	
x 2 times / year (every 6 months)	= $ 600
Payments for braces (18 yr old) $75/mo x 12 mo	= $ 900
Eyeglasses – 1 pair/yr	= $ 300
Monthly prescription co-payments $44 x 12	= $ 540
Total	= $9,540

Since 3% of the household's annual income was already subtracted when considering Emily's disability assistance expenses deduction, the household's $9,540 in annual unreimbursed medical expenses is the allowable deduction.

Medical Expenses Deduction – Applicant Emily

Applicable Low-Income Limit: $42,400

Household Composition:

Emily (who is 45 years of age and legally blind) and her three children (who are 6, 10, and 18 years of age and full-time students)

Household's Annual Income	$60,000
Dependent	- $ 1,440
Child Care Expenses	- $ 6,000
Elderly Household	- $ 400
Disability Assistance	- $ 2,300
Medical Expenses	- $ 9,540
Adjusted Income	$40,320

In our scenario, because our household qualified as an elderly household, we can consider both the disability and the medical expense deductions.

Based on our prior calculations for the household, 3% of the household income is:

Income: $60,000 x 3% = $1,800

Any disability and medical expenses combined which are over 3% of the household income can be considered in the deductions. Since we already calculated this amount when considering the disability assistance deduction, we have shown the medical expense deduction in full based on the prior slide. Let's double check our numbers:

Total Medical Expenses:	**$ 9,540**
Total Disability Expenses:	**$ 4,100**
Combined Total	$13,640
Minus 3% of income	$ 1,800
Equals allowable combined deduction for elderly household:	**$11,840**

By taking the deductions to household income for which the household qualifies, their income of $40,320 is now within the applicable low income limit of $42,400. Thanks to the applying the allowable deductions, this household is income eligible for the Section 502 program.

One last point to remember about deductions is that it is up to the applicant to provide the information for those deductions. If the applicant chooses not to provide information for the deductions, that is their choice.

Adjusted Income – Program Eligibility

Once you have calculated the adjusted income, compare it to the income limits for the programs which can be found at:

http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

Recall that to qualify for the Section 502 program, the household's adjusted income cannot exceed the low-income limit for the applicable location and household size. To qualify for the Section 504 programs, the household's adjusted income cannot exceed the very low-income for the applicable location and household size.

Once you have calculated the adjusted income, compare it to the income limits for the programs which can be found at:
http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do

Recall that to qualify for the Section 502 program, the household's adjusted income cannot exceed the low-income limit for the applicable location and household size. To qualify for the Section 504 programs, the household's adjusted income cannot exceed the very low-income for the applicable location and household size.

Once in RD's Eligibility website, click the "Single Family Housing Direct" tab and then click the "Income Limits" tab. The displayed map shows the adjusted income limits by state, county, and household size. Please note that there is currently an "income banding" pilot in many states. The pilot uses household sizes of 1-4 and 5-8 for the income limits, rather than the individual household sizes of 1,2,3,4,5, etc. The Agency is monitoring the impact of the pilot as part of a possible regulatory change.

The final income type that will be discussed is repayment income.

Definition of Repayment Income

REPAYMENT INCOME is the applicant’s income only and is used to determine the applicant’s ability to repay a loan.

The common income sources and how to verify and project income as previously covered when discussing annual income also apply for repayment income with some notable differences.

REPAYMENT INCOME is the applicant’s income only and is used to determine the applicant’s ability to repay a loan.

Repayment income is income which the applicant(s) receives which is considered a dependable, stable source from which to repay the loan. As a Loan Originator or Loan Approval Official, you must determine what the applicant has for repayment income in order to determine the loan amount for which they applicant qualifies.

Repayment income is projected for the next 12 months, similar to annual and adjusted income calculations. However, unlike those income sources, you are only including the income from the applicant(s) – also known as the note signers and not the income of the entire household. This is because the note signers are agreeing to repay the loan, so their income is used to determine the loan amount.

Additionally, only stable sources of income are included as a source of repayment income. As a lender, the Agency looks to reduce its risk level. By using income that is from stable sources, the Agency has more assurance that the applicant will be a successful homeowner.

The common income sources and how to verify and project income as previously covered when discussing annual income also apply for repayment income with some notable differences.

Differences with Repayment Income

The differences between annual income and repayment income go beyond just scope (household vs. applicant) and purpose (income eligibility vs. ability to repay a loan).

For repayment income:

- The applicant's income is only considered if it is determined to be stable and dependable.
- There are many income sources excluded from annual income but included in repayment income.
- The applicant's nontaxable income is grossed up in the Section 502 program.

Let's go through these differences in more detail.

The differences between annual income and repayment income go beyond just scope (household vs. applicant) and purpose (income eligibility vs. ability to repay a loan). For repayment income:

- The applicant's income is only considered if it is determined to be stable and dependable.

It is highly unlikely that any income source would be guaranteed for the full term of the loan. Rather, an analysis must be done to determine if there is a likelihood that the income will continue into the foreseeable future, based on what has happened in the past and/or what is projected to happen in the future.

If the income source has a strong history of being received, but has a known end date in the near future, then regardless of how stable it has been in the past, you would not consider it for repayment. For instance, an applicant may have been receiving child support for the past 5 years. It is very stable and dependable, but the child turns 18 in 6 months and on his birthday, the support will end. In that case, the income would not be used for repayment income because it has a known end date in the near future.

On the other hand, an income source with a minimal history may be included in repayment income if there is information to show that it is stable and will continue. For instance, an applicant may have just been accepted into an apprenticeship program. The new position includes a pay raise. While she did not have a history of the same income in the past, she has a history of receiving income from that employer, so the additional pay raise from the new position could be considered in repayment income for the applicant.

- There are many income sources excluded from annual income but included in repayment income. Refer to Handbook-1-3550, Chapter 4 for examples.
- The applicant’s nontaxable income is grossed up for repayment income purposes in the Section 502 program.

Stable and Dependable Income

The determination of whether or not the applicant's income is stable and dependable involves looking at the applicant's income history during the last two years and their income expectations for the next two years. Only income that is reliable and likely to continue is included in repayment income.

Since the programs do not have a minimum length of employment (or income) requirement, the historical analysis considers the consistency and pattern of income. It also considers the applicant's situation.

The determination of whether or not the applicant's income is stable and dependable involves looking at the applicant's income history during the last two years and their income expectations for the next two years. Only income that is reliable and likely to continue is included in repayment income.

Since the programs do not have a minimum length of employment (or income) requirement, the historical analysis considers the consistency and pattern of income. It also considers the applicant's situation, such as:

- Multiple employers
- Various types of employment
- Seasonal or temporary employment with various employers and routine periods of unemployment

In these situations, if the applicant's historical income reflects stable similar income from year to year, the income may be considered dependable.

If an applicant has gaps of employment in excess of 30 days, the applicant must provide an explanation, but the gaps in and of themselves do not necessarily indicate that the income is not stable. The concept is to focus on the history of income/employment and whether the history demonstrates a reasonable expectation that similar income will be received in the future.

Let’s look at an example.

Stable and Dependable Income – Applicant John

- Using recent pay stubs from DoughBread, John's projected repayment income is $40,450.
- John's Federal income tax return from last year shows he earned $65,000 from Marlo's Restaurant.
- John's Federal income tax return from two years ago shows he earned $14,480 from University Grill.

Given the fluctuations in income and changes in employers from year-to-year, John's income may seem unstable but further analysis is needed.

In talking with John, we learn that:

- He worked part-time as a server at University Grill while finishing up his degree in restaurant management.
- He graduated in winter and was immediately hired as a full-time restaurant manager for Marlo's Restaurant starting that January. Marlo's is located in a high cost area in California.
- After a year at that position, he relocated to a rural area in Wyoming to be closer to family. Within a month of his relocation, he was hired as a full-time restaurant manager for DoughBread.

During the RD staff's oral verification of employment, DoughBread reported that John's probability of continued employment is likely.

John's income is stable and dependable given his consistency in working in the restaurant industry, his continued likely employment with DoughBread, and the factors driving the fluctuations (i.e. part-time to full-time and wage differentials between high and low cost areas).

While this scenario focuses on John working in the same line of work, another applicant may have worked for multiple employers in the past 2 years, but exhibited income each year of approximately $45,000 and their current job reflects a similar annual projection. The applicant may have worked in multiple industries for multiple employers, but has shown a consistent ability to earn income in the same range. This income history could also be considered stable and dependable.

Stable and Dependable Income – Irregular Income

Irregular income can be considered stable and dependable when there is a consistent pattern of income and a reasonable expectation for its continuation.

For example, an applicant who has a history of working as a farmworker for multiple farm businesses during the production season and drawing unemployment during the off season, could be considered to have stable and dependable income if that trend is likely to continue.

Irregular income can be considered stable and dependable when there is a consistent pattern of income and a reasonable expectation for its continuation.

For example, an applicant who has a history of working as a farmworker for multiple farm businesses during the production season and drawing unemployment during the off season, could be considered to have stable and dependable income if that trend is likely to continue.

Other sources of irregular or seasonally based income may include employment like construction, landscaping, temp agencies, day/union labor, tourism industries (i.e. ski resorts), etc.

Income Sources Included in Repayment Income Only

Below are some (but not all) of the income sources included in repayment income only:

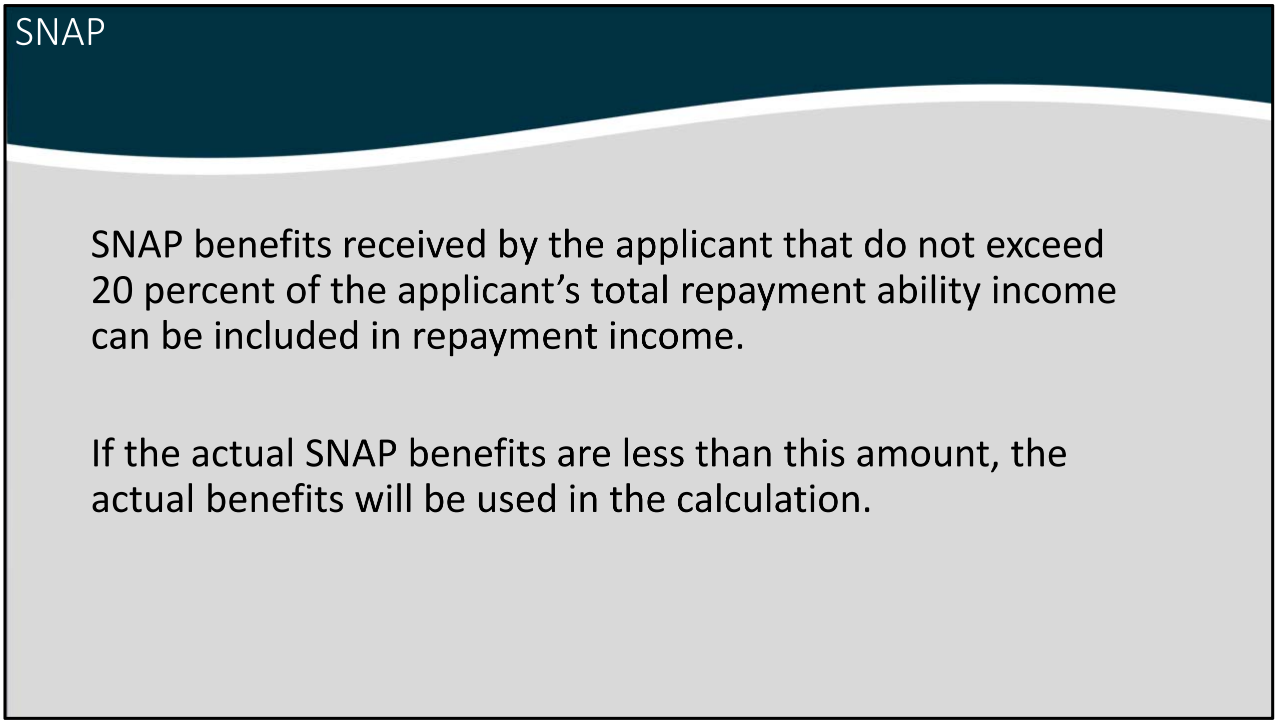
- Housing assistance payments (a.k.a. Section 8).
- Adoption assistance payments in excess of $480 per adopted child.
- Supplemental Nutrition Assistance Program (SNAP) benefits.

There are some income sources which are included only in repayment income. Some, but not all of these sources include:

- Housing assistance payments (a.k.a. Section 8).
- Adoption assistance payments in excess of $480 per adopted child.
- Supplemental Nutrition Assistance Program (SNAP) benefits.

See Handbook-1-3550, Paragraph 4.3 for the entire list.

Since SNAP payments have to be calculated for repayment income in a very specific way, let’s address that next.



SNAP benefits received by the applicant that do not exceed 20 percent of the applicant's total repayment ability income can be included in repayment income.

If the actual SNAP benefits are less than this amount, the actual benefits will be used in the calculation.

Guidance on using SNAP (Food Stamps) payments is in HB-1-3550, Chapter 4. Let's look at an example of how this is calculated.

SNAP - Example

Monthly Repayment Income without SNAP =$1,500

Monthly SNAP Benefit = $400

80% of Repayment Income	
$1,500/.80	=$1,875
Minus Repayment Income	-$1,500
Equals	=$ 375

Lesser of the SNAP benefit or the formula	= $ 375
Allowable Repayment Income (with SNAP)	$1,500 + 375 = $1,875

In this example, the monthly repayment income without SNAP benefits is $1,500. The SNAP benefit is $400/month. To determine the amount to use for SNAP benefits, divide the monthly repayment income without SNAP ($1,500) by .80. This results in $1,875. Next you subtract the monthly repayment income without SNAP from the $1,875, which equals $375.

The allowable amount of SNAP benefits which can be used for repayment income is the lesser of the actual benefits ($400/month) or the resulting formula amount of $375/month. In this case, you would use $375/month for repayment income.

Grossing Up in the Section 502 Program

In the Section 502 program, all nontaxable income will be grossed up to 120% for <u>repayment income</u> with the exception of SNAP benefits.

Examples of nontaxable that will be grossed up include: Social Security, child support, Section 8, etc.

Nontaxable income cannot be grossed-up by any percentage in the Section 504 programs.

In the Section 502 program, all nontaxable income will be grossed up to 120% for <u>repayment income</u> with the exception of SNAP benefits.

Only income which was determined to be stable and dependable can be grossed up. For example, if child support payments are not made as agreed and/or will end in the next two years, they are not considered repayment income and would not be counted as repayment income in any way. However, if it was determined that the income was stable and dependable and it is being used as repayment income, then it will be grossed up.

The standard PITI/TD ratio limitations are based on the assumption that the income is taxable. If the income is not subject to Federal taxes, the amount of continuing tax savings attributable to the nontaxable income will be added to the applicant's repayment income. Nontaxable income will be multiplied by 120% to "gross up" such income.

Before grossing up the income, the repayment income must pass 2 tests: is it stable and dependable and is it expected to continue for 2 years. If these tests are not passed, then the income would not be considered in repayment income in any way and it would not be necessary to gross them up. However, if the income is considered stable and dependable then it will be grossed up for repayment income purposes.

Examples of nontaxable that will be grossed up include: Social Security, child support, Section 8, etc.

Nontaxable income cannot be grossed-up by any percentage in the Section 504 programs.

Grossing Up - Example

The Section 502 applicant has taxable income of $21,000 and nontaxable income $4,000 (Social Security). What is the applicant's total repayment ability?

Taxable income	$21,000
Nontaxable income	
Grossed up ($4,000 X 1.2) =	$ 4,800
Total repayment income	$25,800

In this example, the applicant has $21,000 in taxable income, and $4,000 in nontaxable income. Only the nontaxable income is considered for grossing up. To calculate the amount to consider for repayment income, multiply the full amount of the nontaxable income ($4,000) times 1.2. The result is $4,800. When combined with the $21,000 in taxable income, the applicant's repayment income is now $25,800 instead of $25,000.

While not a significant difference, the calculation does recognize the fact that the nontaxable income has more "spending power" than a taxable income source.

Closing Thoughts

Accurately identifying, verifying, projecting, and calculating income is critical. Mishandling of the three income types can result in inaccurate decisions regarding the applicant's program eligibility and/or the applicant's ability to repay a loan.

To recap:
Accurately identifying, verifying, projecting, and calculating income is critical. Mishandling of the three income types can result in inaccurate decisions regarding the applicant's program eligibility and/or the applicant's ability to repay a loan.

Annual income is the foundation for determining adjusted household income. If the annual income calculation is over- or under-calculated, it could result in the household being considered ineligible for the program, or place them into the wrong income category.

Knowing what deductions to apply to reach an appropriate adjusted income for the household can make the difference between them qualifying for the 502 Program Assistance at all, establishes whether they are low or very-low income, and how much payment assistance for which they qualify. The income category also determines qualifying ratios which affect the loan amount.

Determining Annual, Adjusted, and Repayment Income

In this webinar, we have examined how to determine annual, adjusted, and repayment income.

In future webinars, the following aspects of the application process will be separately discussed in detail: Credit, Repayment Ability, Assets, and Other Eligibility Requirements.

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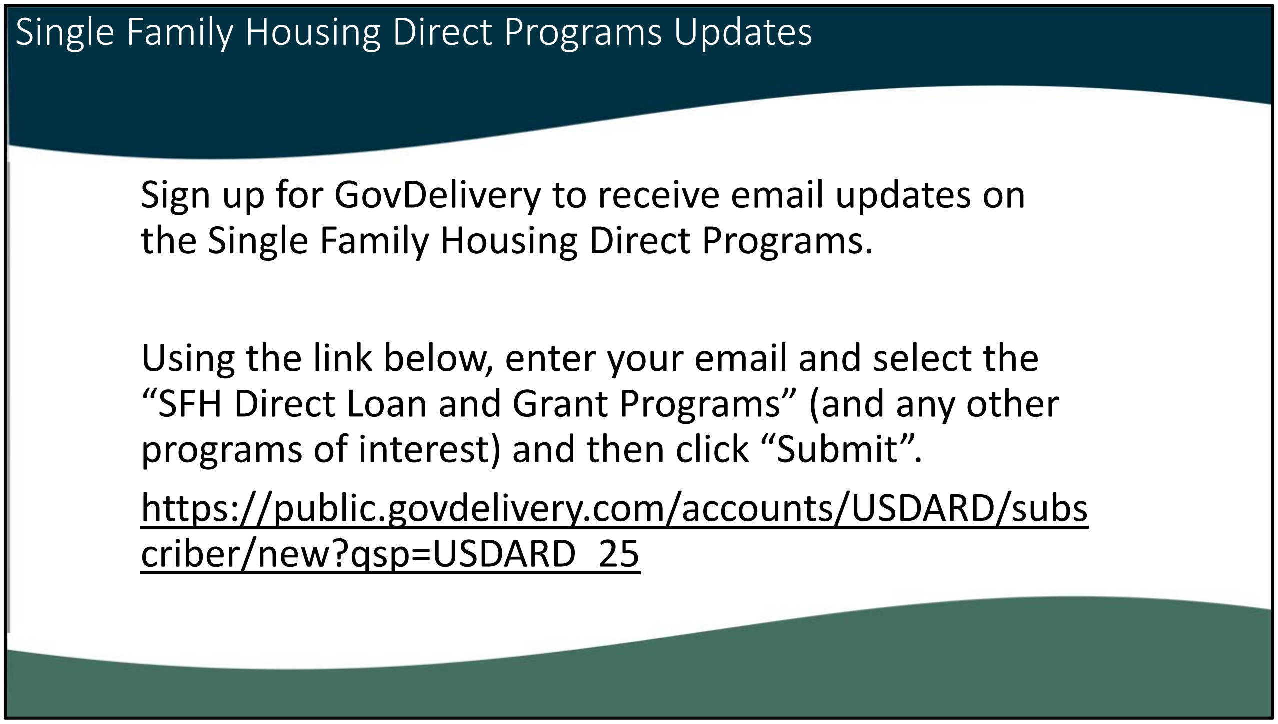

Sign up for GovDelivery to receive email updates on the Single Family Housing Direct Programs.

Using the link on this slide, enter your email and select the "SFH Direct Loan and Grant Programs" (and any other programs of interest) and then click "Submit".

This email subscription service is used to provide updates regarding changes to the:

- Section 502 program's interest rate,
- Handbook-1-3550,
- Certified packaging process,
- And much more….

Are you interested in learning more about the Single Family Housing Direct Programs?

Please contact your applicable RD State Office. Contact information can be found using the link on this slide.

Finally, please note that the contents of this training are current as of this presentation's revision date. Please refer to Handbook-1-3550 for the most recent guidance on the programs.

Thank you for joining us for this webinar on Determining the three income types for the Single Family Housing Direct programs.