

# **HECM FINANCIAL ASSESSMENT AND PROPERTY CHARGE GUIDE**

**REVISED JULY 13, 2016**

**EFFECTIVE FOR HECM CASE  
NUMBERS ASSIGNED ON OR AFTER  
OCTOBER 3, 2016**

# Table of Contents

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<b>Financial Assessment Overview.....</b>	<b>8</b>
1.1 Purpose of the Financial Assessment.....	8
1.2 Documentation of Financial Assessment.....	8
1.3 Loan Application Information .....	8
1.4 DE Underwriter Responsibility.....	8
1.5 Non-discrimination in Performing Financial Assessments.....	9
1.6 FHA’s TOTAL Scorecard.....	9
1.7 Mortgagor Authorization for Verification Information .....	9
1.8 Mortgagor Consent for Social Security Administration to Verify Social Security Number .....	10
1.9 Tax Verification Form or Equivalent.....	10
1.10 Handling of Documents .....	10
1.11 Confidentiality Policy for Credit Information .....	11
1.12 Maximum Age of Mortgage Application Documents .....	12
1.13 Appraisal Validity .....	12
 <b>Credit History and Property Charge Payment History Analysis.....</b>	 <b>13</b>
2.1 Credit History Analysis.....	13
2.2 General Credit Requirements.....	13
2.3 Types of Credit History .....	14
2.4 Traditional Credit History – Credit Report Requirements.....	14
2.5 Traditional Credit History – Updated Credit Report or Supplement to the Credit Report.....	15
2.6 Traditional Credit History – Credit Information not Listed on Credit Report.....	15
2.7 Traditional Credit History – Specific Requirements for Residential Mortgage Credit Report.....	16
2.8 Non-Traditional and Insufficient Credit History .....	16
2.9 Non-Traditional Credit – Non-Traditional Mortgage Credit Report Requirements	16
2.10 Independent Verification of Non-Traditional Credit Providers.....	17
2.11 Sufficiency of Credit References .....	18
2.12 Evaluating Credit History – General.....	19
2.13 Types of Payment Histories .....	19
2.14 Payment History on Housing Obligations .....	19

2.15 Satisfactory Credit .....	20
2.16 Credit Requiring Additional Analysis .....	20
2.17 Collection Accounts.....	21
2.18 Charge Off Accounts .....	21
2.19 Disputed Derogatory Credit Accounts.....	22
2.20 Judgments .....	22
2.21 Delinquent Federal Non –Tax Debt.....	23
2.22 Delinquent FHA-Insured Mortgages .....	24
2.23 Delinquent Federal Tax Debt.....	25
2.24 Chapter 7 Bankruptcy .....	25
2.25 Chapter 13 Bankruptcy .....	26
2.26 Property Charge Payment History Analysis .....	26
2.27 Definition of Property Charges .....	27
2.28 Satisfactory Property Charge Payment History .....	27
2.29 Property Charge Payment History Requiring Further Analysis .....	28
<b>Cash Flow/Residual Income Analysis .....</b>	<b>29</b>
3.1 Purpose of the Cash Flow/ Residual Income Analysis .....	29
3.2 Mortgagor Income .....	29
3.3 General Income Requirements.....	29
3.4 Income from a Eligible Non-Borrowing Spouse .....	30
3.5 Income from Other Non-Borrowing Household Members.....	30
3.6 Non-Taxable Income .....	31
3.7 Employment-Related Income – General.....	31
3.8 Traditional Current Employment Documentation .....	31
3.9 Alternative Current Employment Documentation .....	32
3.10 Past Employment Documentation.....	32
3.11 Calculation of Effective Income – Salary .....	33
3.12 Calculation of Effective Income – Hourly.....	33
3.13 Part-Time Income .....	33
3.14 Calculating Part-Time Income .....	33
3.15 Overtime and Bonus Income .....	33
3.16 Calculating Overtime and Bonus income .....	34
3.17 Seasonal Income .....	34
3.18 Calculating Seasonal Income .....	34

3.19 Employer Housing Subsidy .....	34
3.20 Calculating Employer Housing Subsidy Income .....	34
3.21 Income from Employment with Family-Owned Business.....	35
3.22 Calculating Income from Income from Employment with Family-Owned Business .....	35
3.23 Commission Income .....	36
3.24 Calculating Commission Income .....	36
3.25 Self-Employment Income .....	36
3.26 Required Documentation for Self-Employed Income .....	37
3.27 Calculating Self-Employed Income .....	38
3.28 Frequent Changes in Employment.....	38
3.29 Gaps in Employment.....	38
3.30 Temporary Reductions in Income.....	39
3.31 Disability Benefits .....	39
3.32 Social Security Disability Benefits .....	40
3.33 Veterans Affairs Disability Benefits .....	40
3.34 Private Disability Benefits .....	40
3.35 Calculating Disability Income .....	41
3.36 Alimony, Child Support, Maintenance Income .....	41
3.37 Calculating Alimony, Child Support, Maintenance Income.....	41
3.38 Military Income .....	42
3.39 Calculating Military Income .....	42
3.40 Other Public Assistance .....	42
3.41 Calculating Other Public Assistance Income.....	42
3.42 Automobile Allowances.....	43
3.43 Calculating Automobile Allowance Income.....	43
3.44 Social Security Retirement Income .....	43
3.45 Calculating Social Security Retirement Income .....	44
3.46 Pension Income.....	45
3.47 Calculating Pension Income .....	45
3.48 Individual Retirement Account and 401(k) Income .....	45
3.49 Calculating Individual Retirement Account and 401(k) Income .....	46
3.50 Rental Income from the Subject Property.....	46
3.51 Calculating Rental Income from the Subject Property .....	47
3.52 Rental Income – Other Real Estate Holdings .....	47
3.53 Calculating Rental Income From Other Real Estate Holdings .....	48

3.54 Income from Boarders of the Subject Property .....	49
3.55 Calculating Rental Income from Boarders .....	50
3.56 Investment Income.....	50
3.57 Calculating Investment income.....	50
3.58 Capital Gains and Losses .....	50
3.59 Expected Income.....	51
3.60 Calculating Expected Income .....	51
3.61 Trust Accounts Income .....	51
3.62 Calculating Trust Accounts Income.....	52
3.63 Annuities or Similar Income .....	52
3.64 Calculating Annuities and Similar Income .....	52
3.65 Notes Receivable Income .....	52
3.66 Calculating Notes Receivable Income .....	52
3.67 Government Assistance Non-Cash Benefits.....	53
3.68 Imputed Income from Asset Dissipation .....	53
3.69 Asset Dissipation Calculation Table.....	54
3.70 Assets – Checking and Savings Accounts .....	55
3.71 Assets – Cash on Hand .....	56
3.72 Assets – Retirement Accounts .....	56
3.73 Assets – Stocks and Bonds .....	57
3.74 Assets – Private Savings Clubs.....	57
3.75 Expense Analysis.....	58
3.76 Liens Paid Off Using HECM Proceeds .....	58
3.77 General Liabilities and Debts.....	58
3.78 Undisclosed Debts and Inquiries .....	59
3.79 Federal Debt.....	59
3.80 Allimony, Child Support and Maintenance .....	60
3.81 Deferred Obligations.....	60
3.82 Installment Loans.....	61
3.83 Student Loans.....	61
3.84 Revolving Charge Accounts .....	62
3.85 30 Day Accounts.....	62
3.86 Business Debt in Mortgagor’s Name.....	63
3.87 Disputed Derogatory Accounts.....	63
3.88 Non-Derogatory Disputed Account and Disputed Accounts Not Indicated on the Credit Report.....	64

3.89 Contingent Liabilities.....	64
3.90 Collection Accounts.....	65
3.91 Charge Off Accounts .....	66
3.92 Private Savings Clubs .....	66
3.93 Federal and State Income Taxes .....	66
3.94 Maintenance and Utility Charges.....	66
3.95 Documentation Standards for Property Charges.....	67
3.96 Expense Analysis for Non-Borrowing Spouse .....	67
3.97 Expense Analysis for Other Non-Borrowing Household Members .....	68
3.98 Property Taxes as a Percentage of Gross Income .....	68
3.99 Residual Income.....	68
3.100 Residual Income Table .....	69
3.101 States Included in Regions.....	70
3.102 Model Financial Assessment Worksheet .....	70
<b>Extenuating Circumstances and Compensating factors .....</b>	<b>71</b>
4.1 Extenuating Circumstances.....	71
4.2 Extenuating Circumstances – Unemployment.....	72
4.3 Compensating Factors.....	72
4.4 Compensating Factors – Other Sources of Income.....	72
4.5 Compensating Factors – Other Resources .....	73
4.6 Documenting Extenuating Circumstances, Compensating Factors .....	74
<b>Property Charge Funding Requirements .....</b>	<b>75</b>
5.1 Life Expectancy Set-Aside .....	75
5.2 Projected Life Expectancy Property Charges .....	75
5.3 Projected Life Expectancy Property Charges Cost Formula .....	76
5.4 Life Expectancy Set-Aside Must Be Fully Funded .....	76
5.5 Life Expectancy Set-Aside Must Be Partially Funded .....	77
5.6 Partially Funded Life Expectancy Set-Aside Formula .....	77
5.7 Additional Requirement for Use of Partially Funded Life Expectancy Set-Aside .....	78
5.8 Life Expectancy Table .....	78
5.9 Life Expectancy Set-Aside and Loan Decision .....	78

<b>Appendix 1-</b> Appendix L to Part 1026—Assumed Loan Periods for Computations of Total Annual Loan Cost Rates .....	80
<b>Appendix 2</b> - Analyzing IRS Forms.....	82

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# Financial Assessment Overview

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## 1.1 Purpose of the Financial Assessment

The mortgagee must evaluate the mortgagor's willingness and capacity to timely meet his or her financial obligations and comply with the mortgage requirements, and determine if the HECM will represent a sustainable solution to the mortgagor's financial circumstances.

In conducting this financial assessment, mortgagees must take into consideration that some mortgagors seek a HECM due to financial difficulties, which may be reflected in the mortgagor's credit report and/or property charge payment history. The mortgagee must also consider to what extent the proceeds of the HECM could provide a solution to any such financial difficulties.

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## 1.2 Documentation of Financial Assessment

Mortgagees must include documentation for the information used to conduct the financial assessment in the origination case binder. The documentation must be filed in accordance with the requirements of *HECM Endorsement List* available on FHA's HECM for Lenders site at <http://portal.hud.gov/hudportal/documents/huddoc?id=14-22ml-atc1.pdf>

Unless stated otherwise, Days in this Guide refer to calendar days.

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## 1.3 Loan Application Information

All required information on income, expenses, assets and liabilities is not captured on Fannie Mae Form 1009, *Residential Loan Application for Reverse Mortgages*. Mortgagees must capture additional required information using Parts IV, V and VI of Fannie Mae Form 1003, *Uniform Residential Loan Application*, or through an alternative form developed to capture the same information. Mortgagees must ensure that the mortgagor certifies to the accuracy and completeness of the financial information provided, regardless of the form used.

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## 1.4 DE Underwriter Responsibility

A Direct Endorsement (DE) underwriter registered in FHA Connection by the underwriting mortgagee must complete the financial assessment. The mortgagee must document its assessment of required financial information on a financial assessment worksheet that has been signed by the DE Underwriter.

The mortgagee must place this worksheet on the right-hand side of the HECM endorsement case binder directly after the request for late endorsement (if applicable).

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## Financial Assessment Overview, Continued

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### **1.4 DE Underwriter Responsibility (continued)**

A model worksheet is available at FHA's HECM for Lenders site under *HUD Model Loan Documents* at [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/sfh/model\\_documents](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/model_documents).

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### **1.5 Non- discrimination in Performing Financial Assessments**

The mortgagee must fully comply with all applicable provisions of:

- Title VIII of the Civil Rights Act of 1968 (Fair Housing Act);
- the Fair Credit Reporting Act, Public Law 91-508; and
- the Equal Credit Opportunity Act, Public Law 94-239 and 12 CFR Part 202.

The financial assessment must be conducted in a uniform manner that shall not discriminate because of race, color, religion, sex, age, national origin, familial status, disability, marital status, actual or perceived sexual orientation, gender identity, source of income of the mortgagor, or location of the property.

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### **1.6 FHA's TOTAL Scorecard**

Mortgagees must not use FHA's Technology Open To Approved Lenders (TOTAL) Scorecard for HECMs.

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### **1.7 Mortgagor Authorization for Verification Information**

The mortgagee must obtain the mortgagor's authorization to verify the information needed to perform the financial assessment. The mortgagee must obtain an Eligible Non-Borrowing Spouse's or Other Non-Borrowing Household Member's authorization (see Sections 3.4 and 3.5 for definitions of Eligible Non-Borrowing Spouse and Other Non-Borrowing Household Member) where necessary to verify income and liabilities when the Eligible Non-Borrowing Spouse's or Other Non-Borrowing Household Member's income will be used as a Compensating Factor or to reduce family size. See Section 2.2 for further information. The mortgagor's and Eligible Non-Borrowing Spouse's or Other Non-Borrowing Household Member's authorization may be accomplished through a blanket authorization form.

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## Financial Assessment Overview, Continued

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### **1.8 Mortgagor Consent for Social Security Administration to Verify Social Security Number**

The mortgagee must obtain the mortgagor's signature on Part IV of Form HUD-92900-A, *HUD/VA Addendum to Uniform Residential Loan Application*, to verify the mortgagor's SSN with the SSA.

The mortgagee must obtain a Non-Borrowing Spouse's signature on Part IV of Form HUD-92900-A to verify the Non-Borrowing Spouse's SSN with the SSA.

Part IV of Form HUD-92900-A refers to "Co-borrower" rather than Non-Borrowing Spouse. Lenders may cross out "Co-borrower" and write in Non-Borrowing Spouse, or attach an addendum signed by the Non-Borrowing Spouse to Form HUD-92900-A which includes the required language in Part IV of Form HUD-92900-A.

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### **1.9 Tax Verification Form or Equivalent**

The mortgagee must obtain the mortgagor's signature on the appropriate Internal Revenue Service (IRS) form to obtain tax returns directly from the IRS for all mortgagors at the time the Final Fannie Mae Form 1009 is executed.

Where income from an Eligible Non-Borrowing Spouse or Other Non-Borrowing Household Member will be used as a Compensating Factor or to reduce family size, the Eligible Non-Borrowing Spouse or Other Non-Borrowing Household Member may also be required to sign the appropriate IRS form

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### **1.10 Handling of Documents**

Mortgagees must not accept or use documents relating to the employment, income, assets, or credit of mortgagors that have been handled by, or transmitted from or through the equipment of unknown parties or Interested Parties. Interested Parties refer to sellers, real estate agents, builders, developers or other parties with an interest in the transaction. Mortgagees may not accept or use any third party verifications that have been handled by, or transmitted from or through, any Interested Party or the mortgagor.

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## Financial Assessment Overview, Continued

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### **1.10 Handling of Documents (continued)**

#### **Information Sent to the Mortgagee Electronically**

The mortgagee must authenticate all documents received electronically by examining the source identifiers (e.g., fax banner header or the sender's email address) or contacting the source of the document by telephone to verify the document's validity. The mortgagee must document the name and telephone number of the individual with whom the mortgagee verified the validity of the document.

#### **Information Obtained via Internet**

The mortgagee must authenticate documents obtained from an Internet website and examine portions of printouts downloaded from the Internet including the Uniform Resource Locator (URL) address, as well as the date and time the documents were printed. The mortgagee must visit the URL or the main website listed in the URL if the page is password protected to verify the website exists and print out evidence documenting the mortgagee's visit to the URL and website.

Documentation obtained through the Internet must contain the same information as would be found in an original hard copy of the document.

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### **1.11 Confidentiality Policy for Credit Information**

Mortgagees must not divulge sources of credit information, except as required by a contract or by law. All personnel with access to credit information must ensure that the use and disclosure of information from a credit report complies with:

- Title VIII of the Civil Rights Act of 1968 (Fair Housing Act);
  - the Fair Credit Reporting Act, Public Law 91-508;
  - the Right to Privacy Act, Public Law 93-579;
  - the Financial Privacy Act, Public Law 95-630; and
  - the Equal Credit Opportunity Act, Public Law 94-239 and 12 CFR Part 202.
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## Financial Assessment Overview, Continued

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### **1.12 Maximum Age of Mortgage Application Documents**

Documents used in the financial assessment may not be more than 120 Days old at the disbursement date. Documents whose validity for financial assessment purposes is not affected by the passage of time, such as divorce decrees or tax returns, may be more than 120 Days old at the disbursement date.

For purposes of counting days for periods provided in this Guide, Day one is the Day after the effective or issue date of the document, whichever is later.

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### **1.13 Appraisal Validity**

The appraisal is valid for 120 days. The 120 Day validity period for an appraisal may be extended for 30 Days at the option of the mortgagee if (1) the mortgagee approved the mortgagor or HUD issued the firm commitment before the expiration of the original appraisal; or (2) the mortgagor signed a valid sales contract prior to the expiration date of the appraisal.

An appraisal update must be performed before the initial appraisal, with no extension, has expired. Where the initial appraisal is subsequently updated, the updated appraisal is valid for a period of 240 Days after the effective date of the original appraisal report that is being updated.

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# Credit History and Property Charge Payment History Analysis

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## **2.1 Credit History Analysis**

The mortgagee must determine if the mortgagor has demonstrated the willingness to timely meet his or her financial obligations by analyzing the mortgagor's credit history.

Mortgagees must pay particular attention to situations where serious derogatory credit such as foreclosures, bankruptcies, defaults, and late mortgage payments are on the mortgagor's record. Absent documented Extenuating Circumstances, serious derogatory credit under such circumstances must be viewed as especially significant events that call into question the ability of the mortgagor to manage his or her financial obligations.

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## **2.2 General Credit Requirements**

The mortgagee must analyze the mortgagor's credit history, liabilities, and debts to determine the willingness of the mortgagor to meet his or her financial obligations.

The mortgagee must either obtain a tri-merged credit report (TRMCR) or a Residential Mortgage Credit Report (RMCR) from an independent consumer reporting agency.

The mortgagee must obtain a credit report for each mortgagor who will be obligated on the mortgage note. The mortgagee may obtain a joint report for individuals with joint accounts.

The mortgagee must only obtain a credit report for an Eligible Non-Borrowing Spouse or Other Non-Borrowing Household Member where his or her income will be used as a Compensating Factor or to reduce family size when determining if residual income is sufficient, even if the property is located in a community property state.

The credit report for an Other Non-Borrowing Household Member must indicate that his or her SSN, where an SSN exists, was matched with the SSA, or the mortgagee must either provide separate documentation indicating that the SSN was matched with the SSA or provide a statement that the Other Non-Borrowing Household Member does not have an SSN.

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# Credit History and Property Charge Payment History Analysis, Continued

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## 2.2 General Credit Requirements (continued)

Where a SSN does not exist for an Other Non-Borrowing Household Member, the Other Non-Borrowing Household Member's credit report must contain, at a minimum, the full name, date of birth, and previous addresses for the last two years.

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## 2.3 Types of Credit History

If a traditional credit report is available, the mortgagee must use a traditional credit report. However, if a traditional credit report is not available, and the mortgagor is applying for a **HECM for Purchase**, the mortgagee must develop the mortgagor's credit history using the requirements for Non-Traditional and Insufficient Credit. See Sections 2.8-2.11.

Mortgagees are not required to develop non-traditional credit for mortgagors for whom a traditional credit report is not available when they are seeking a **Traditional or Refinance HECM**. The mortgagor may be deemed to have an acceptable credit history.

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## 2.4 Traditional Credit History – Credit Report Requirements

If the TRMCR or RMCR generates a credit score, the mortgagee must utilize traditional credit history.

Credit reports must obtain all information from at least two credit repositories pertaining to credit, residence history, and public records information, be in an easy to read and understandable format, and not require code translations. The credit report may not contain whiteouts, erasures, or alterations. The mortgagee must retain copies of all credit reports.

The credit report must include:

- name of the mortgagee ordering the report;
- name, address, and telephone number of the consumer-reporting agency;
- name and SSN of each mortgagor; and
- primary repository from which any particular information was pulled, for each account listed.

A truncated SSN is acceptable for FHA mortgage insurance purposes provided that the mortgage application captures the full 9-digit SSN.

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# Credit History and Property Charge Payment History Analysis, Continued

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## 2.4

### **Traditional Credit History – Credit Report Requirements (continued)**

The credit report must also include:

- all inquiries made within the last 90 Days;
  - all credit and legal information not considered obsolete under the Fair Credit Reporting Act (FCRA), including information for the last seven years regarding;
    - bankruptcies;
    - judgments;
    - lawsuits;
    - foreclosures; and
    - tax liens; and
  - for each mortgagor debt listed, the:
    - date the account was opened;
    - high credit amount;
    - required monthly payment amount;
    - unpaid balance; and
    - payment history.
- 

## 2.5

### **Traditional Credit History - Updated Credit Report or Supplement to the Credit Report**

The mortgagee must obtain an updated credit report or supplement if the mortgagee identifies inconsistencies between any information in the mortgage file and the original credit report.

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## 2.6

### **Traditional Credit History - Credit Information not Listed on Credit Report**

The mortgagee must develop credit information separately for any open debt listed on the mortgage application or equivalent but not referenced in the credit report by using the procedures for Independent Verification of Non-Traditional Credit History provided in Section 2.10.

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# Credit History and Property Charge Payment History Analysis, Continued

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## 2.7 Traditional Credit History - Specific Requirements for Residential Mortgage Credit Report

In addition to meeting the general credit report requirements, the RMCR must:

- provide a detailed account of the mortgagor's employment history;
  - verify each mortgagor's current employment and income through an interview with the mortgagor's employer or explain why such an interview was not completed;
  - contain a statement attesting to the certification of employment for each mortgagor and the date the information was verified; and
  - report a credit history for each trade line within 90 Days of the credit report for each account with a balance.
- 

## 2.8 HECM for Purchase Only Non- Traditional and Insufficient Credit History

For mortgagors without a credit score applying for a **HECM for Purchase**, the mortgagee must either obtain a Non-Traditional Mortgage Credit Report (NTMCR) from a credit reporting company or independently develop the mortgagor's credit history using the requirements outlined in Section 2.10.

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## 2.9 HECM for Purchase Only Non- Traditional Credit – Non- Traditional Mortgage Credit Report Requirements

A NTMCR is designed to access the credit history of a mortgagor applying for a **HECM for Purchase** who does not have the types of trade references that appear on a traditional credit report and used either as:

- a substitute for a TRMCR or an RMCR; or
- a supplement to a traditional credit report that has an insufficient number of trade items reported to generate a credit score.

Mortgagees may use a NTMCR developed by a credit reporting agency that verifies the following information for all non-traditional credit references:

- the existence of the credit providers;
  - that the credit was actually extended to the mortgagor; and
  - the creditor has a published address or telephone number.
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# Credit History and Property Charge Payment History Analysis, Continued

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## 2.9 **HECM for Purchase Only** Non- Traditional Credit – Non- Traditional Mortgage Credit Report Requirements (continued)

The NTMCR must not include subjective statements such as “satisfactory” or “acceptable,” must be formatted in a similar fashion to traditional references, and provide the:

- creditor’s name;
  - date of opening;
  - high credit;
  - current status of the account;
  - 12-month history of the account;
  - required monthly payment;
  - unpaid balance; and
  - payment history in the delinquency categories (for example, 0x30 and 0x60).
- 

## 2.10 **Independent Verification of Non- Traditional Credit Providers**

The following requirements are applicable to **Traditional and Refinance** HECMs where credit information must be developed separately (see Section 2.6) and to **HECM for Purchase** transactions where traditional credit is not available (See Section 2.3).

The mortgagee may independently verify the mortgagor’s credit references by documenting the existence of the credit provider and that the provider extended credit to the mortgagor.

To verify the existence of each credit provider, the mortgagee must review public records from the state, county, or city or other documents providing a similar level of objective information.

To verify credit information, the mortgagee must:

- use a published address or telephone number for the credit provider and not rely solely on information provided by the mortgagor; and
- obtain the most recent 12 months of canceled checks, or equivalent proof of payment, demonstrating the timing of payment to the credit provider.

To verify the mortgagor’s rental payment history, the mortgagee must obtain a rental reference from the appropriate rental management company, provided the mortgagor is not renting from a family member, demonstrating the timing of payment of the most recent 12 months in lieu of 12 months of canceled checks or equivalent proof of payment.

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# Credit History and Property Charge Payment History Analysis, Continued

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## 2.11 HECM for Purchase Only Sufficiency of Credit References

To be sufficient to establish the mortgagor's credit, the credit history must include three credit references, including at least one of the following:

- rental housing payments (subject to independent verification if the mortgagor is a renter);
- telephone service; or
- utility company reference (if not included in the rental housing payment), including:
  - gas;
  - electricity;
  - water;
  - television service; or
  - Internet service.

If the mortgagee cannot obtain all three credit references from the list above, the mortgagee may use the following sources of unreported recurring debt:

- insurance premiums not payroll deducted (for example, medical, auto, life, renter's insurance);
- payment to child care providers made to businesses that provide such services;
- school tuition;
- retail store credit cards (for example, from department, furniture, appliance stores, or specialty stores);
- rent-to-own (for example, furniture, appliances);
- payment of that part of medical bills not covered by insurance;
- a documented 12 month history of savings evidenced by regular deposits resulting in an increased balance to the account that:
  - were made at least quarterly;
  - were not payroll deducted; and
  - caused no insufficient funds (NSF) checks;
- an automobile lease;
- a personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments; or
- a documented 12-month history of payment by the mortgagor on an account for which the mortgagor is an authorized user.

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# Credit History and Property Charge Payment History Analysis, Continued

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## **2.12 Evaluating Credit History - General**

The mortgagee must examine the mortgagor's overall pattern of credit behavior, not just isolated unsatisfactory or slow payments, to determine the mortgagor's ability to manage their financial obligations.

The mortgagee must not consider the credit history of a Non-Borrowing Spouse or Other Non-Borrowing Household Member, even if the property is located in a community property state

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## **2.13 Types of Payment Histories**

The mortgagee must evaluate the mortgagor's payment histories in the following order: (1) current or previous mortgage debt and housing-related expenses including utilities; (2) installment debts; and (3) revolving accounts.

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## **2.14 Payment History on Housing Obligations**

The mortgagee must determine the mortgagor's housing obligation payment history for the mortgagor's principal residence through:

- the credit report;
- verification of rent received directly from the landlord (for landlords with no identity-of-interest with the mortgagor);
- verification of mortgage received directly from the mortgage servicer; or
- a review of canceled checks that cover the most recent 12-month period.

The mortgagee must verify and document the previous 12 months' housing history for the mortgagor's principal residence. For mortgagors who indicate they are living mortgage or rent-free, the mortgagee must obtain verification through the title report or other information, or if they are not the owner, from the property owner where they are residing, that the mortgagor has been living rent-free and the amount of time the mortgagor has been living rent free.

A mortgage that has been modified must utilize the payment history in accordance with the modification agreement for the time period of modification in determining late housing payments.

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## Credit History and Property Charge Payment History Analysis, Continued

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### 2.15 Satisfactory Credit

The mortgagee may consider the mortgagor to have satisfactory credit if:

- the mortgagor has made all housing and installment debt payments on-time for the previous 12 months and no more than two 30-day late mortgage payments or installment payments in the previous 24 months; and
- the mortgagor has no major derogatory credit on revolving accounts in the previous 12 months.

Major derogatory credit on revolving accounts shall include any payments made more than 90 Days after the due date, or three or more payments more than 60 Days after the due date.

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### 2.16 Credit Requiring Additional Analysis

If a mortgagor's credit history does not reflect satisfactory credit as stated above, the mortgagor's payment history requires additional analysis.

The mortgagee must analyze the mortgagor's delinquent accounts to determine whether late payments were based on a disregard for financial obligations, an inability to manage debt, or Extenuating Circumstances (see Section 4.1). The mortgagee must document this analysis in the mortgage file. Any explanation or documentation of delinquent accounts must be consistent with other information in the file.

Where the mortgagor has not demonstrated the willingness to meet his or her financial obligations as stated above and no Extenuating Circumstances can be documented, the mortgagee must at a minimum require a Fully Funded Life Expectancy Set-Aside (LESA). See Sections 5.4 and 5.9.

Even where a Fully Funded LESA is required mortgagees must still determine if the mortgagor's credit history provides reasonable assurance that the mortgagor can effectively manage financial obligations even if real estate taxes and insurance are paid for directly by the mortgagee through the LESA.

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*Continued on next page*

## Credit History and Property Charge Payment History Analysis, Continued

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### **2.17 Collection Accounts**

A collection account is a mortgagor's loan or debt that has been submitted to a collection agency through a creditor.

The mortgagee must determine if collection accounts were a result of:

- the mortgagor's disregard for financial obligations;
- the mortgagor's inability to manage debt; or
- Extenuating Circumstances.

The mortgagee must document reasons for approving a mortgagor for a HECM when the mortgagor has any collection accounts.

The mortgagor must provide a letter of explanation, which is supported by documentation, for each outstanding collection account. The explanation and supporting documentation must be consistent with other credit information in the file.

Refer to Section 3.90 for additional requirements where the mortgagor has more than \$2,000 in Collection Accounts

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### **2.18 Charge Off Accounts**

A Charge Off Account refers to a mortgagor's loan or debt that has been written off by the creditor.

The mortgagee must determine if charge off accounts were a result of:

- the mortgagor's disregard for financial obligations;
- the mortgagor's inability to manage debt; or
- Extenuating Circumstances.

The mortgagee must document reasons for approving a mortgagor for a HECM when the mortgagor has any charge off accounts.

The mortgagor must provide a letter of explanation, which is supported by documentation, for each outstanding charge off account. The explanation and supporting documentation must be consistent with other credit information in the file.

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*Continued on next page*

# Credit History and Property Charge Payment History Analysis, Continued

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## **2.19 Disputed Derogatory Credit Accounts**

Disputed Derogatory Credit Account refers to disputed charge off accounts, disputed collection accounts, and disputed accounts with late payments in the last 24 months.

The mortgagee must analyze the documentation provided for consistency with other credit information to determine if the derogatory credit account should be considered in the financial assessment.

The following items need not be considered by the mortgagee:

- disputed medical accounts, and
- disputed derogatory credit resulting from identity theft, credit card theft or unauthorized use provided the mortgagee includes a copy of the police report or other documentation from the creditor to support the status of the account in the mortgage file.

If the credit report indicates that the mortgagor is disputing derogatory credit accounts, the mortgagor must provide a letter of explanation and documentation supporting the basis of the dispute.

If the disputed derogatory credit resulted from identity theft, credit card theft or unauthorized use balances, the mortgagee must obtain a copy of the police report or other documentation from the creditor to support the status of the accounts.

Refer to Section 3.87 for additional requirements where the mortgagor has more than \$1,000 in Disputed Derogatory Accounts

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## **2.20 Judgments**

Judgment refers to any debt or monetary liability of the mortgagor created by a court, or other adjudicating body. The mortgagee must verify that court-ordered judgments are resolved or paid off prior to or at closing.

Regardless of the amount of outstanding judgments, the mortgagee must determine if the judgment was a result of

- the mortgagor's disregard for financial obligations;
  - the mortgagor's inability to manage debt; or
  - Extenuating Circumstances.
- 

*Continued on next page*

## Credit History and Property Charge Payment History Analysis, Continued

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### 2.20 Judgments (continued)

A judgment is considered resolved if the mortgagor has entered into a valid agreement with the creditor to make regular payments on the debt, the mortgagor has made timely payments for at least three months of scheduled payments and the judgment will not supersede the FHA-insured mortgage lien.

The mortgagor cannot prepay scheduled payments in order to meet the required minimum of three months of payments.

The mortgagee must include the agreed payment amount in the mortgagor's expenses when calculating residual income.

The mortgagee must obtain a copy of the agreement and evidence that payments were made on time in accordance with the agreement.

The mortgagee must provide the following documentation:

- evidence of payment in full, if paid prior to settlement; or
- payoff statement, if paid at settlement; or
- payment arrangement with creditor, if not paid prior to or at settlement, and a subordination agreement for any liens existing on title.

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### 2.21 Delinquent Federal Non- Tax Debt

Mortgagees are prohibited from processing an application for an FHA-insured mortgage for mortgagors with delinquent federal non-tax debt, including deficiency judgments and other debt associated with past FHA-insured mortgages. Mortgagees must suspend processing of the application until the debt has been resolved with the creditor agency. Mortgagees are required to determine whether the mortgagors have delinquent federal non-tax debt. Mortgagees may obtain information on delinquent federal debts from public records, credit reports or equivalent, and must check all mortgagors against the Credit Alert Verification Reporting System (CAIVRS).

If a delinquent federal debt is reflected in a public record, credit report or equivalent, CAIVRS or an equivalent system, the mortgagee must verify the validity and delinquency status of the debt by contacting the creditor agency to whom the debt is owed. If the debt was identified through CAIVRS, the mortgagee must contact the creditor agency using the contact phone number and debt reference number reflected in the borrower's CAIVRS report.

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*Continued on next page*

# Credit History and Property Charge Payment History Analysis, Continued

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## 2.21 Delinquent Federal Non- Tax Debt (continued)

If the creditor agency confirms that the debt is valid and in delinquent status as defined by the Debt Collection Improvement Act (<http://www.dol.gov/ocfo/media/regs/DCIA.pdf>), then the mortgagor is ineligible for an FHA-insured mortgage until the mortgagor resolves the debt with the creditor agency.

The mortgagee may not find a mortgagor ineligible solely on the basis of CAIVRS information that has not been verified by the mortgagee. If resolved either by determining that the information in CAIVRS is no longer valid or by resolving the delinquent status as stated above, the mortgagee may continue to process the mortgage application.

In order for a mortgagor with verified delinquent federal debt to become eligible, the mortgagor must resolve their federal non-tax debt in accordance with the Debt Collection Improvement Act.

The creditor agency that is owed the debt can verify that the debt has been resolved in accordance with the Debt Collection Improvement Act. The mortgagee must include documentation from the creditor agency to support the verification and resolution of the debt. For debt reported through CAIVRS, the mortgagee may obtain evidence of resolution by obtaining a clear CAIVRS report.

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## 2.22 Delinquent Mortgages

If the mortgagor is currently delinquent on an FHA-insured mortgage on their principal residence, and the HECM will pay off the delinquent mortgage, the mortgagor may be eligible provided they meet all other HECM requirements.

However, in all cases where there is a delinquent mortgage on the principal residence, whether FHA-insured or not, mortgagees must evaluate the circumstances leading to the delinquency, and determine whether the HECM pay-off represents a sustainable solution to the issues that caused the delinquency.

If the mortgagor is currently delinquent on other FHA-insured mortgages associated with investment properties, they are ineligible for a new FHA-insured mortgage unless the delinquency is resolved.

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*Continued on next page*



## Credit History and Property Charge Payment History Analysis, Continued

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### 2.23 Delinquent Federal Tax Debt

Mortgagors with delinquent federal tax debt are ineligible. Mortgagees must suspend processing of the application until the debt has been resolved with the creditor agency.

Tax liens may remain unpaid if the mortgagor has entered into a valid repayment agreement with the federal agency owed to make regular payments on the debt and the mortgagor has made timely payments for at least three months of scheduled payments. The mortgagor cannot prepay scheduled payments in order to meet the required minimum of three months of payments.

The mortgagee must include the agreed payment amount in the mortgagor's expenses when calculating residual income.

Mortgagees must check public records and credit information to verify that the mortgagor is not presently delinquent on any federal debt and does not have a tax lien placed against their property for a debt owed to the federal government.

The mortgagee must include documentation from the IRS evidencing the repayment agreement and verification of payments made, if applicable.

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### 2.24 HECM for Purchase Only Chapter 7 Bankruptcy

A Chapter 7 bankruptcy (liquidation) does not disqualify a mortgagor from consideration for a **HECM for Purchase** if, at the time of case number assignment, at least two years have elapsed since the date of the bankruptcy discharge. During this time, the mortgagor must have:

- re-established good credit; or
- chosen not to incur new credit obligations.

An elapsed period of less than two years, but not less than 12 months, may be acceptable, if the mortgagor:

- can show that the bankruptcy was caused by Extenuating Circumstances beyond the mortgagor's control; and
  - has since exhibited a documented ability to manage his or her financial affairs in a responsible manner.
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# Credit History and Property Charge Payment History Analysis, Continued

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**2.24**  
**HECM for**  
**Purchase Only**  
**Chapter 7**  
**Bankruptcy**  
(continued)

If the credit report does not verify the discharge date or additional documentation is necessary to determine if any liabilities were discharged in the bankruptcy, the mortgagee must obtain the bankruptcy and discharge documents.

The mortgagee must also document that the mortgagor's current situation indicates that the events which led to the bankruptcy are not likely to recur.

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**2.25**  
**HECM for**  
**Purchase Only**  
**Chapter 13**  
**Bankruptcy**

A Chapter 13 bankruptcy does not disqualify a mortgagor from consideration for a **HECM for Purchase**, if at the time of case number assignment at least 12 months of the pay-out period under the bankruptcy has elapsed.

The mortgagee must determine that during this time, the mortgagor's payment performance has been satisfactory and all required payments have been made on time; and the mortgagor has received written permission from bankruptcy court to enter into the mortgage transaction

The mortgagee must include the payment amount in the court-approved payment plan in the mortgagor's expenses when calculating residual income.

If the credit report does not verify the discharge date or additional documentation is necessary to determine if any liabilities were discharged in the bankruptcy, the mortgagee must obtain the bankruptcy and discharge documents.

The mortgagee must also document that the mortgagor's current situation indicates that the events that led to the bankruptcy are not likely to recur.

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**2.26**  
**Property**  
**Charge**  
**Payment**  
**History**  
**Analysis**

The mortgagee must determine if the mortgagor has demonstrated the willingness to timely meet his or her financial obligations by analyzing the mortgagor's property charge payment history.

Mortgagees must pay particular attention to situations where late property charge payments are on the mortgagor's record. Absent documented Extenuating Circumstances (see Section 4.1), such circumstances must be viewed as especially significant events that call into question the ability of the mortgagor to manage his or her financial obligations.

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*Continued on next page*

# Credit History and Property Charge Payment History Analysis, Continued

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## 2.27 Definition of Property Charges

Property charges include:

- all property taxes – school, city, county, state, etc.
  - where a taxing authority has permanently waived or otherwise permanently exempted the mortgagor from payment of property taxes, i.e., taxes are not due and payable and do not accrue or result in a lien against the property, such taxes may be excluded from the financial assessment. Documentation for the waiver or exemption must be placed in the case binder.
  - where a taxing authority has deferred the payment of property taxes, i.e., liability for taxes remains, but payment is deferred until a certain point in the future, such taxes may be excluded from the financial assessment provided:
    - that the deferral period will be in place until the death of the mortgagor or the sale of the property, whichever occurs first;
    - that a lien senior to the HECM first and second mortgages will not be created upon the termination of the deferral period;
    - documentation on the deferral is placed in the case binder; and
    - the mortgagor shall not participate in a real estate tax deferral program or permit any liens to be recorded against the property, unless such liens are subordinate to the insured mortgage and any second mortgage held by the Secretary;
- homeowners/hazard insurance and flood insurance;
- homeowners association (HOA), condominium and planned unit development (PUD) fees;
- ground rents; and
- other assessments levied by municipalities or under State law.

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## 2.28 Satisfactory Property Charge Payment History

The mortgagee may consider the mortgagor to have a satisfactory property charge payment history where, at the time of loan application:

- all property taxes for all owned real estate are current and there are no property tax arrearages in the prior 24 months;
- all HOA, condominium, or PUD fees for all owned real estate are current and there were no arrearages in the prior 24 months.

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# Credit History and Property Charge Payment History Analysis, Continued

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## **2.28 Satisfactory Property Charge Payment History (continued)**

The mortgagee must determine and document the reason for any late payments, e.g., disregard for financial obligations, an inability to manage debt, or if there were Extenuating Circumstances.

Where the mortgagor owns no other real estate, and has changed his or her principal residence within the last 24 months, the mortgagee must review the property charge payment history for the current principal residence and the prior principal residence for a combined 24 months

If homeowners/hazard insurance and flood insurance (if applicable) were not in place for the mortgagor's principal residence for the previous 12 months, mortgagors must obtain coverage and prepay for 12 months at or before mortgage closing.

Even where a Fully Funded LESA is required mortgagees must still determine if the mortgagor's property charge payment history provides reasonable assurance that the mortgagor can effectively manage financial obligations even if real estate taxes and insurance are paid for directly by the mortgagee through the LESA.

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## **2.29 Property Charge Payment History Requiring Further Analysis**

If a mortgagor's property charge payment history is not Satisfactory as stated above, the mortgagor's property charge payment history requires additional analysis.

The mortgagee must determine whether late payments and/or the assessment of late fees or penalties were based on a disregard for financial obligations, an inability to manage debt, or Extenuating Circumstances (see Section 4.1). The mortgagee must document this analysis in the mortgage file. Any explanation or documentation of late payments must be consistent with other information in the file.

Where the mortgagor has not demonstrated the willingness to meet his or her financial obligations as stated above and no Extenuating Circumstances can be documented, the mortgagee must, at a minimum, require a Fully Funded LESA. See Sections 5.4 and 5.9.

Even where a Fully Funded LESA is required mortgagees must still determine if the mortgagor's property charge payment history provides reasonable assurance that the mortgagor can effectively manage financial obligations even if real estate taxes and insurance are paid for directly by the mortgagee through the LESA.

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## Cash Flow/Residual Income Analysis

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### **3.1 Purpose of the Cash Flow/ Residual Income Analysis**

The purpose of the cash flow/residual income analysis is to determine the capacity of the mortgagor to meet his or her documented financial obligations with his or her documented income.

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### **3.2 Mortgagor Income**

Income from any, or all, of the sources described in Chapter 3 must be calculated and documented for all mortgagors to the extent necessary to determine that the mortgagor has residual income equal to, or exceeding, the required amount based on geographic region and family size. See Table of Residual Income in Section 3.100.

If the mortgagee can determine that the mortgagor's residual income is sufficient based on documentation for one or more specific sources, it need not pursue additional documentation for additional sources of income.

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### **3.3 General Income Requirements**

Effective income refers to income that may be used in the calculation of residual income. Effective income must be reasonably likely to continue through at least the first three years of the mortgage. The mortgagee must document the mortgagor's income and employment history, verify the accuracy of the amounts of income being reported, and determine if the income can be considered as effective income in accordance with the requirements listed below.

The mortgagee may only consider income if it is legally derived and, when required, properly reported as income on the mortgagor's tax returns.

Negative income must be subtracted from the mortgagor's gross monthly income and not treated as a recurring monthly liability unless otherwise noted.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.4 Income from an Eligible Non- Borrowing Spouse**

An “Eligible Non-Borrowing Spouse” is a Non-Borrowing Spouse who meets the Qualifying Attributes requirements defined in Mortgagee Letter 2014-07 for a deferral period.

[http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/sfh/hecm/hecmml](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/hecm/hecmml)

An Eligible Non-Borrowing Spouse may voluntarily provide information on his or her income and mortgagees may use the residual income of the Eligible Non-Borrowing Spouse in one of two ways:

- as a compensating factor; or
- to reduce the family size by one (see Table of Residual Income in Section 3.100).

To be used as a Compensating Factor or to reduce family size, the Eligible Non-Borrowing Spouse’s income must meet the same documentation and verification standards as required for the mortgagor’s income. Non-taxable income may not be grossed up, and imputed income from dissipated assets may not be included.

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### **3.5 Income from Other Non- Borrowing Household Members**

“Other Non-Borrowing Household Member” is defined as a person who occupies the property to be secured with the HECM, who is not the spouse of the mortgagor and who also is not a mortgagor. An Other Non-Borrowing Household Member may voluntarily provide information on his or her income and mortgagees may use his or her residual income to reduce the family size. See Table of Residual Income in Section 3.100.

To be used to reduce family size, the Other Non-Borrowing Household Member’s income must meet the same documentation and verification standards as required for the mortgagor’s income. Non-taxable income may not be grossed up, and imputed income from dissipated assets may not be included.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.6 Non-Taxable Income

Non-Taxable Income refers to types of income not subject to federal taxes, which includes, but is not limited to:

- some portion of Social Security Income;
- some federal government employee retirement income;
- Railroad Retirement benefits;
- some state government retirement income;
- certain types of disability and public assistance payments;
- child support;
- military allowances; and
- other income that is documented as being exempt from federal income taxes.

Non-taxable income may be counted as effective income. However, because the cash flow/residual income analysis will take into account federal taxes, it will be reflected in the expense analysis for residual income. Non-taxable income therefore, may not be “grossed up.”

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### 3.7 Employment- Related Income - General

Employment Income refers to income received as an employee of a business that is reported on IRS Form W-2. The mortgagee may use employment related income as effective income in accordance with the standards provided for each type of employment related income.

For all employment related income, the mortgagee must verify the mortgagor’s most recent two years of employment and income, and document using one of the methods below.

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### 3.8 Traditional Current Employment Documentation

The mortgagee must obtain the most recent pay stubs covering a minimum of 30 consecutive days (if paid weekly or bi-weekly, pay stubs must cover a minimum of 28 consecutive days) that show the mortgagor’s year-to-date earnings, and one of the following to verify current employment:

- a written verification of employment (VOE) covering two years; or
- an electronic verification acceptable to FHA.

Re-verification of employment must be completed within 10 Days prior to mortgage disbursement. Verbal re-verification of employment is acceptable.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.9 Alternative Current Employment Documentation

If using alternative documentation, the mortgagee must:

- obtain copies of the pay stubs covering the most recent 30 consecutive day period (if paid weekly or bi-weekly, pay stubs must cover a minimum of 28 consecutive days) that show the mortgagor's year-to-date earnings;
- obtain copies of the original IRS W-2 forms from the previous two years; and
- document current employment by telephone, sign and date the verification documentation, and note the name, title, and telephone number of the person with whom employment was verified.

Re-verification of employment must be completed within 10 Days prior to the date of the note. Verbal re-verification of employment is acceptable.

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### 3.10 Past Employment Documentation

Direct verification of the mortgagor's employment history for the previous two years is not required if all of the following conditions are met:

- the current employer confirms a two year employment history, or a paystub reflects a hiring date;
- only base pay is used in calculating effective income (no overtime or bonus income); and
- the mortgagor executes IRS Form 4506, *Request for Copy of Tax Return*, IRS Form 4506-T, *Request for Transcript of Tax Return*, or IRS Form 8821, *Tax Information Authorization*, for the previous two tax years.

If the mortgagor has not been employed with the same employer for the previous two years and/or not all conditions immediately above can be met, then the mortgagee must obtain one or a combination of the following for the most recent two years to verify the mortgagor's employment history:

- W-2(s);
  - VOE(s);
  - electronic verification acceptable to FHA; or
  - evidence supporting enrollment in school or the military during the most recent two full years.
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## Cash Flow/Residual Income Analysis, Continued

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### **3.11 Calculation of Effective Income - Salary**

For employees who are salaried and whose income has been and will likely be consistently earned, the mortgagee must use the current salary to calculate effective income.

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### **3.12 Calculation of Effective Income - Hourly**

For employees who are paid hourly, and whose hours do not vary, the mortgagee must consider the mortgagor's current hourly rate to calculate effective income.

For employees who are paid hourly and whose hours vary, the mortgagee must average the income over the previous two years. If the mortgagee can document an increase in pay rate the mortgagee may use the most recent 12-month average of hours at the current pay rate.

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### **3.13 Part-Time Income**

Part-time employment refers to employment that is not the mortgagor's primary employment and is generally performed for less than 40 hours per week. The mortgagee may use part-time income as effective income if the mortgagor has worked a part-time job uninterrupted for the past two years and the current position is reasonably likely to continue.

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### **3.14 Calculation of Part-Time Income**

The mortgagee must average the income over the previous two years. If the mortgagee can document an increase in pay rate the mortgagee may use a 12-month average of hours at the current pay rate.

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### **3.15 Overtime and Bonus Income**

Overtime and bonus income refers to income that the mortgagor receives in addition to the mortgagor's normal salary. The mortgagee may use overtime and bonus income as effective income if the mortgagor has received this income for the past two years and it is reasonably likely to continue.

Periods of overtime and bonus income less than two years may be considered effective income if the mortgagee documents that the overtime and bonus income has been consistently earned over a period of not less than one year and is reasonably likely to continue.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.16 Calculating Overtime and Bonus Income**

For employees with bonus or overtime income, the mortgagee must average the income earned over the previous two years to calculate effective income. However, if the overtime or bonus income from the current year decreases by 20 percent or more from the previous year, the mortgagee must use the current year's income.

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### **3.17 Seasonal Income**

Seasonal employment refers to employment that is not year round, regardless of the number of hours per week the mortgagor works on the job. The mortgagee may consider seasonal employment as effective income if the mortgagor has worked the same line of work for the past two years and is reasonably likely to be rehired for the next season. The mortgagee may consider unemployment income as effective income for those with effective income from seasonal employment.

For seasonal employees with unemployment income, the mortgagee must document the unemployment income for 2 full years and there must be reasonable assurance that this income will continue.

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### **3.18 Calculating Seasonal Income**

For employees with income from seasonal employment, the mortgagee must average the income earned over the previous two full years to calculate effective income.

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### **3.19 Employer Housing Subsidy**

Employer housing subsidy refers to employer provided housing assistance. The mortgage may utilize employer housing subsidy as effective income.

The mortgagee must verify and document the existence and the amount of the housing subsidy.

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### **3.20 Calculating Employer Housing Subsidy Income**

For employees receiving an employer housing subsidy, the mortgagee may add the employer housing subsidy to the total effective income.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.21 Income from Employment with Family- Owned Business

Family-owned business income refers to income earned from a business owned by the mortgagor's family, but in which the mortgagor is not an owner.

The mortgagee may consider family-owned business income as effective income if the mortgagor is not an owner in the family-owned business.

The mortgagee must verify and document that the mortgagor is not an owner in the family-owned business by using official business documents showing the ownership percentage.

Official business documents include corporate resolutions or other business organizational documents, business tax returns or Schedule K-1 (IRS Form 1065), *U.S. Return of Partnership Income*, or an official letter from a certified public accountant on their business letterhead.

In addition to traditional or alternative documentation requirements, the mortgagee must obtain copies of signed personal tax returns or tax transcripts

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### 3.22 Calculating Income from Income from Employment with Family- Owned Business

#### **Salary**

For employees who are salaried and whose income has been and will likely continue to be consistently earned, the mortgagee must use the current salary to calculate effective income.

#### **Hourly**

For employees who are paid hourly, and whose hours do not vary, the mortgagee must consider the mortgagor's current hourly rate to calculate effective income.

For employees who are paid hourly and whose hours vary, the mortgagee must average the income over the previous two years. If the mortgagee can document an increase in pay rate the mortgagee may use the most recent 12-month average of hours at the current pay rate.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.23 Commission Income

Commission income refers to income that is paid contingent upon the conducting of a business transaction or the performance of a service.

The mortgagee may use commission income as effective income if the mortgagor earned the income for at least one year in the same or similar line of work and it is reasonably likely to continue.

For commission income less than or equal to 25 percent of the mortgagor's total earnings, the mortgagee must use traditional or alternative employment documentation.

For commission income greater than 25 percent of the mortgagor's total earnings, the mortgagee must obtain signed tax returns including all applicable schedules, for the last two years. In lieu of signed tax returns from the borrower, the mortgagee may obtain a signed IRS Form 4506, *Request for Copy of Tax Return*, IRS Form 4506-T, *Request for Transcript of Tax Return*, or IRS Form 8821, *Tax Information Authorization*, and tax transcripts directly from the IRS.

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### 3.24 Calculating Commission Income

The mortgagee must calculate effective income for commission by using the lesser of (a) the average net commission income earned over the previous two years, or the length of time commission income has been earned if less than two years; or (b) the average net commission income earned over the previous one year. The mortgagee must calculate net commission income by subtracting the unreimbursed business expenses from the gross commission income.

The mortgagee must reduce the effective income by the amount of any unreimbursed employee business expenses, as shown on the mortgagor's Schedule A. See Appendix 2, Analyzing IRS Forms

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### 3.25 Self- Employment Income

Self-employment income refers to income generated by a business in which the mortgagor has a 25 percent or greater ownership interest.

There are four basic types of business structures. They include:

- sole proprietorships;
  - corporations;
  - limited liability or "S" corporations; and
  - partnerships.
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## Cash Flow/Residual Income Analysis, Continued

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### **3.25 Self- Employment Income (continued)**

The mortgagee may consider self-employed mortgagor income if the mortgagor has been self-employed for at least two years.

If the mortgagor has been self-employed between one and two years, the mortgagee may only consider the income as effective income if the mortgagor was previously employed in the same line of work in which the mortgagor is self-employed or in a related occupation for at least two years.

Income obtained from businesses with annual earnings that are stable or increasing is acceptable. If the income from businesses shows a greater than 20 percent decline in effective income over the analysis period, the mortgagee must document that the business income is now stable.

A mortgagee may consider income as stable after a 20 percent reduction if the mortgagee can document the reduction in income was the result of an Extenuating Circumstance, and the mortgagor can demonstrate the income has been stable or increasing for a minimum of 12 months.

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### **3.26 Required Documentation for Self- Employed Income**

The mortgagee must obtain signed, completed federal individual and business income tax returns, including all schedules.

In lieu of signed individual or business tax returns from the mortgagor, the mortgagee may obtain a signed IRS Form 4506, *Request for Copy of Tax Return*, IRS Form 4506-T, *Request for Transcript of Tax Return*, or IRS Form 8821, *Tax Information Authorization*, and tax transcripts directly from the IRS.

The mortgagee must obtain a year-to-date profit and loss (P&L) statement and balance sheet if more than a calendar quarter has elapsed since date of most recent calendar or fiscal year-end tax return was filed by the mortgagor. A balance sheet is not required for self-employed mortgagors filing Schedule C income.

If income used to calculate residual income exceeds the two year average of tax returns, an audited P&L or signed quarterly tax return obtained from IRS is required.

The mortgagee must obtain a business credit report for all corporations and "S" corporations.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.27 Calculating Self-Employed Income**

The mortgagee must analyze the mortgagor's tax returns to determine gross self-employment income See Appendix 2, Analyzing IRS Forms.

The mortgagee must calculate gross self-employment income by using the lesser of:

- the average gross self- employment income earned over the previous two years; or
  - the average gross self-employment income earned over the previous one year.
- 

### **3.28 Frequent Changes in Employment**

If the mortgagor has changed employers more than three times in the previous 12-month period, or has changed lines of work, the mortgagee must take additional steps to verify and document the stability of the mortgagor's employment income. Additional analysis is not required for fields of employment that regularly require a mortgagor to work for various employers such as Temp Companies or Union Trades. The mortgagee must obtain:

- transcripts of training and education demonstrating qualification for a new position; or
  - employment documentation evidencing continual increases in income and/or benefits.
- 

### **3.29 Gaps in Employment**

For mortgagors with gaps in employment of six months or more (an extended absence), the mortgagee may consider the mortgagor's current income as effective income if it can verify and document that:

- the mortgagor has been employed in the current job for at least six months at the time of case number assignment; and
  - a two- year work history prior to the absence from employment using standard or alternative employment verification.
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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.30 Temporary Reductions in Income**

For mortgagors with a temporary reduction of income due to a short-term disability or similar temporary leave, the mortgagee may consider the mortgagor's current income as effective income, if it can verify and document that:

- the mortgagor intends to return to work;
- the mortgagor has the right to return to work; and
- the mortgagor meets the applicable Residual Income standard in Section 3.100 taking into account any reduction of income due to the circumstance.

The mortgagee must provide the following documentation for mortgagors on temporary leave:

- a written statement from the mortgagor confirming the mortgagor's intent to return to work, and the intended date of return; and
- documentation generated by current employer confirming the mortgagor's eligibility to return to current employer after temporary leave; and
- documentation of sufficient liquid assets used to supplement the mortgagor's income through intended date of work with current employer.

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### **3.31 Disability Benefits**

Disability benefits refer to benefits received from the SSA, Department of Veterans Affairs (VA), or a private disability insurance provider. The mortgagee must verify and document the mortgagor's receipt of benefits from the SSA, VA, or private disability insurance provider. The mortgagee must obtain documentation that establishes award of benefits to the mortgagor.

If any disability income is due to expire within three years from the date of mortgage application, that income cannot be used as effective income. If the Notice of Award or equivalent document does not have a defined expiration date, the mortgagee may consider the income effective and reasonably likely to continue. The mortgagee may not rely upon a pending or current re-evaluation of medical eligibility for benefit payments as evidence that the benefit payment is not reasonably likely to continue.

Under no circumstance may the mortgagee inquire into or request documentation concerning the nature of the disability or the medical condition of the mortgagor.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.32 Social Security Disability Benefits**

For Social Security Disability income, including Supplemental Security Income (SSI), the mortgagee must obtain a copy of the last Notice of Award letter, or an equivalent document that established award benefits to the mortgagor, and one of the following documents:

- federal tax returns;
  - the most recent bank statement evidencing receipt of income from the SSA;
  - a Proof of Income Letter, also known as a “Budget Letter” or “Benefits Letter” that evidences income from the SSA; or
  - a copy of the mortgagor’s Form SSA-1099/1042S, *Social Security Benefit Statement*.
- 

### **3.33 Veterans Affairs Disability Benefits**

For VA disability benefits, the mortgagee must obtain from the mortgagor a copy of the veteran’s last Benefits Letter showing the amount of the assistance, and one of the following documents:

- federal tax returns; or
- The most recent bank statement evidencing receipt of income from the VA.

If the Benefits Letter does not have a defined expiration date, mortgagees may consider the income effective and likely to continue for at least three years.

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### **3.34 Private Disability Benefits**

For private disability benefits, the mortgagee must obtain documentation from the private disability insurance provider showing the amount of the assistance and the expiration date of the benefits, if any, and one of the following documents:

- federal tax returns; or
  - the most recent bank statement evidencing receipt of income from the insurance provider.
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## Cash Flow/Residual Income Analysis, Continued

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### **3.35 Calculating Disability Income**

The mortgagee must use the most recent amount of benefits received to calculate effective income.

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### **3.36 Alimony, Child Support, Maintenance Income**

Alimony, child support, or maintenance income refers to income received from a former spouse or partner or from a non-custodial parent of the mortgagor's minor dependent. The mortgagee must obtain a fully executed copy of the mortgagor's final divorce decree, legal separation agreement, court order, or voluntary payment agreement with documented receipt.

When using a final divorce decree, legal separation agreement or court order, the mortgagee must obtain evidence of receipt using deposits on bank statements, canceled checks, or documentation from the child support agency for the most recent three months that supports the amount used in the income analysis.

The mortgagee must document the voluntary payment agreement with 12 months of canceled checks, deposit slips, or tax returns.

The mortgagee must provide evidence that the claimed income will continue for at least three years. The mortgagee may use the front and pertinent pages of the divorce decree/settlement agreement and/or court order showing the financial details.

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### **3.37 Calculating Alimony, Child Support, Maintenance Income**

When using a final divorce decree, legal separation agreement or court order, if the mortgagor has received consistent alimony, child support or other maintenance payments for the most recent three months, the mortgagee may use the current payment to calculate effective income.

When using evidence of voluntary payments, if the mortgagor has received consistent alimony, child support or other maintenance payments for the most recent six months, the mortgagee may use the current payment to calculate effective income.

If the alimony, child support or other maintenance payments have not been consistently received for the most recent six months, the mortgagee must use the average of the income received over the previous two years to calculate effective income. If alimony, child support or maintenance income has been received for less than two years, the mortgagee must use the average over the time of receipt.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.38 Military Income**

Military income refers to income received by military personnel during their period of active, Reserve, or National Guard service, including:

- base pay
- Basic Allowance for Housing
- clothing allowances
- flight or hazard pay
- Basic Allowance for Subsistence
- proficiency pay

The mortgagee may not use education benefits as effective income.

The mortgagee must obtain a copy of the mortgagor's military Leave and Earnings Statement (LES). The mortgagee must verify the Expiration Term of Service date on the LES. If the Expiration Term of Service date is within the first 12 months of the mortgage, military income may only be considered effective income if the mortgagor represents their intent to continue military service.

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### **3.39 Calculating Military Income**

The mortgagee must use the current amount of military income received to calculate effective income.

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### **3.40 Other Public Assistance**

Public assistance refers to income received from government assistance programs.

Mortgagees must verify and document the income received from the government agency. If any public assistance income is due to expire within three years from the date of mortgage application, that income cannot be used as effective income. If the documentation does not have an expiration date, the mortgagee may consider the income effective and reasonably likely to continue.

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### **3.41 Calculating Other Public Assistance Income**

The mortgagee must use the current rate of public assistance received to calculate effective income.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.42 Automobile Allowances**

Automobile allowance refers to the funds provided by the mortgagor's employer for automobile related expenses.

The mortgagee must verify and document the automobile allowance received from the employer for the previous two years.

The mortgagee must also obtain IRS Form 2106, *Employee Business Expenses*, for the previous two years.

---

### **3.43 Calculating Automobile Allowance Income**

The mortgagee must determine the portion of the allowance that can be considered effective income.

The mortgagee must subtract automobile expenses as shown on IRS Form 2106 from the automobile allowance before calculating effective income based on the current amount of the allowance received.

If the mortgagor uses the standard per-mile rate in calculating automobile expenses, as opposed to the actual cost method, the portion that the IRS considers depreciation may be added back to income. Expenses that must be treated as recurring debt include:

- the mortgagor's monthly car payment; and
- any loss resulting from the calculation of the difference between the actual expenditures and the expense account allowance.

Automobile allowance refers to the amount of automobile allowance that exceeds the mortgagor's actual automobile expenditures.

---

### **3.44 Social Security Retirement Income**

Social Security Income or Supplemental Security Income (SSI) refers to income received from the SSA other than disability income.

The mortgagee must verify and document the mortgagor's receipt of income from the SSA and that it is likely to continue for at least a three year period from the date of case number assignment.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.44 Social Security Retirement Income (continued)

For SSI, the mortgagee must obtain any one of the following documents:

- federal tax returns;
- the most recent bank statement evidencing receipt of income from the SSA;
- a Proof of Income Letter, also known as a “Budget Letter” or “Benefits Letter” that evidences income from the SSA; or
- a copy of the mortgagor’s SSA Form-1099/1042S, *Social Security Benefit Statement*.

In addition to verification of income, the mortgagee must document the continuance of this income by obtaining from the mortgagor (1) a copy of the last Notice of Award letter, which states the SSA’s determination on the mortgagor’s eligibility for SSA income, or (2) equivalent documentation that establishes award benefits to the mortgagor (equivalent document). If any income from the SSA is due to expire within three years from the date of case number assignment, that income may not be used in calculating residual income.

If the Notice of Award or equivalent document does not have a defined expiration date, the mortgagee must consider the income effective income and reasonably likely to continue. The mortgagee may not request additional documentation to demonstrate continuance of Social Security income.

If the Notice of Award letter or equivalent document specifies a future start date for receipt of income, this income may only be considered effective on the specified start date.

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### 3.45 Calculating Social Security Retirement Income

The mortgagee must use the current amount of Social Security income received to calculate effective income.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.46 Pension Income**

Pension refers to income received from the mortgagor's former employer(s).

The mortgagee must verify and document the mortgagor's receipt of periodic payments from the mortgagor's pension and that the payments are likely to continue for at least three years.

The mortgagee must obtain any one of the following documents:

- federal tax returns;
- the most recent bank statement evidencing receipt of income from the former employer; or
- a copy of the mortgagor's pension/retirement letter from the former employer.

If the source of the pension income is the federal government, including VA, the mortgagee must consider the income effective and reasonably likely to continue. The mortgagee is not required to request additional documentation from the mortgagor to demonstrate continuance of federal government pension income.

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### **3.47 Calculating Pension Income**

The mortgagee must use the current amount of pension income received to calculate effective income.

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### **3.48 Individual Retirement Account and 401(k) Income**

Individual Retirement Account (IRA/401(k)) income refers to income received from an IRA.

The mortgagee must verify and document the mortgagor's receipt of recurring IRA/401(k) distribution income and that it is reasonably likely to continue for three years.

The mortgagee must obtain the most recent IRA/401(k) statement and any one of the following documents:

- federal tax returns; or
  - the most recent bank statement evidencing receipt of income.
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## Cash Flow/Residual Income Analysis, Continued

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### 3.49 Calculating Individual Retirement Account and 401(k) Income

For mortgagors with IRA/401(k) income that has been and will be consistently received, the mortgagee must use the current amount of IRA/401(k) income received to calculate effective income. For mortgagors with fluctuating IRA/401(k) income, the mortgagee must use the average of the IRA/401(k) income received over the previous two years to calculate effective income. If IRA/401(k) income has been received for less than two years, the mortgagee must use the average over the time of receipt.

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### 3.50 Rental Income from the Subject Property

Rental income from the subject property refers to income received when the subject property has 2-4 units.

The mortgagee may consider rental income from existing and prospective tenants if documented in accordance with the following requirements.

#### **Limited or No History of Rental Income**

Where the mortgagor does not have a history of rental income from the subject property since the previous tax filing the mortgagee must verify and document the proposed rental income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and the prospective leases, if available.

#### **History of Rental Income**

Where the mortgagor has a history of rental income from the subject property since the previous tax filing, the mortgagee must verify and document the existing rental income by obtaining the current lease, rental history over the previous 24 months that is free of unexplained gaps greater than three months (such gaps could be explained by student, seasonal or military renters, or property rehabilitation), and the mortgagor's most recent tax returns, including Schedule E, from the previous two years.

For properties with less than two years of rental income history, the mortgagee must document the date of acquisition by providing the deed, closing disclosure or other legal document.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.51 Calculating Rental Income from the Subject Property

The mortgagee must add the net subject property rental income to the mortgagor's gross income.

#### **Limited or No History of Rental Income**

To calculate the effective income from the subject property where the mortgagor does not have a history of rental income from the subject property since the previous tax filing, the mortgagee must use the lesser of:

- the monthly operating income reported on Fannie Mae Form 216/Freddie Mac Form 998, or
- 75 percent of the lesser of:
  - fair market rent reported by the appraiser; or
  - the rent reflected in the lease or other rental agreement

#### **History of Rental Income**

The mortgagee must calculate the rental income by averaging the amount shown on the Schedule E.

Depreciation, mortgage interest, taxes, insurance and any HOA dues shown on Schedule E may be added back to the net income or loss.

If the property has been owned for less than two years, the mortgagee must annualize the rental income for the length of time the property has been owned.

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### 3.52 Rental Income – Other Real Estate Holdings

Rental income from other real estate holdings may be considered effective income, if the documentation requirements listed below are met. If rental income is being derived from the property being vacated by the mortgagor, the mortgagor must be relocating to an area more than 100 miles from the mortgagor's current principal residence. The mortgagee must obtain a lease agreement of at least one year's duration after the mortgage is closed and evidence of the payment of the security deposit or first month's rent.

#### **Limited or No History of Rental Income**

Where the mortgagor does not have a history of rental income since the previous tax filing, including property being vacated by the mortgagor, the mortgagee must obtain an appraisal evidencing market rent and that the mortgagor has at least 25 percent equity in the property. The appraisal is not required to be completed by an FHA Roster appraiser.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.52

#### **Rental Income – Other Real Estate Holdings** (continued)

- **Two to Four Units**

The mortgagee must verify and document the proposed rental income by obtaining an appraisal showing fair market rent (use Fannie Mae Form 1025/Freddie Mac Form 72, *Small Residential Income Property Appraisal Report*) and the prospective leases if available

- **One Unit**

The mortgagee must verify and document the proposed rental income by obtaining a Fannie Mae Form 1004/Freddie Mac Form 70, *Uniform Residential Appraisal Report*, Fannie Mae Form 1007/Freddie Mac Form 1000, *Single Family Comparable Rent Schedule*, and Fannie Mae Form 216/Freddie Mac Form 998, *Operating Income Statement*, showing fair market rent and, if available, the prospective lease.

#### **History of Rental Income**

The mortgagee must obtain the mortgagor's last two years tax returns with Schedule E.

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### 3.53

#### **Calculating Rental Income from Other Real Estate Holdings**

#### **Limited or No History of Rental Income**

To calculate the effective net rental income from other real estate holdings where the mortgagor does not have a history of rental income since the previous tax filing, the mortgagee must deduct the principal, interest, taxes and insurance payment (PITI) from the lesser of:

- The monthly operating income reported on Fannie Mae Form 216/Freddie Mac Form 998, or
  - 75 percent of the lesser of:
    - fair market rent reported by the appraiser; or
    - the rent reflected in the lease or other rental agreement.
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## Cash Flow/Residual Income Analysis, Continued

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### 3.53 Calculating Rental Income from Other Real Estate Holdings (continued)

#### History of Rental Income

The mortgagee must calculate the net rental income by averaging the amount shown on the Schedule E provided the mortgagor continues to own all properties included on the Schedule E.

Depreciation shown on Schedule E may be added back to the net income or loss.

If the property has been owned for less than two years, the mortgagee must annualize the rental income for the length of time the property has been owned.

For properties with less than two years of rental income history, the mortgagee must document the date of acquisition by providing the deed, closing disclosure or other legal document.

Positive net rental income must be added to the mortgagor's effective income. Negative net rental income must be included as a debt/liability.

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### 3.54 Income from Boarders of the Subject Property

Boarder refers to an individual renting space inside the mortgagor's dwelling unit.

Rental income from boarders is only acceptable if the mortgagor has a two-year history of receiving income from boarders that is shown on the tax return and the mortgagor is currently receiving boarder income.

The mortgagee must obtain two years of the mortgagor's tax returns evidencing income from boarders and the current lease.

For **HECM for Purchase** transactions, the mortgagee must obtain a copy of the executed written agreement documenting their intent to continue boarding with the mortgagor.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.55 Calculating Rental Income from Boarders

The mortgagee must calculate the effective income by using the lesser of the two-year average or the current lease.

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### 3.56 Investment Income

Investment income refers to interest and dividend income received from assets such as certificates of deposits, mutual funds, stocks, bonds, money markets, and savings and checking accounts.

The mortgagee must verify and document the mortgagor's investment income by obtaining tax returns for the previous two years and the most recent account statement.

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### 3.57 Calculating Investment Income

The mortgagee must calculate investment income by using the lesser of

- the average investment income earned over the previous two years; or
- the average investment income earned over the previous one year.

The mortgagee must subtract any of the assets used for the required cash investment for a **HECM for Purchase**, or where the mortgagor is otherwise required to bring cash to closing, from the mortgagor's liquid assets prior to calculating any interest or dividend income.

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### 3.58 Capital Gains and Losses

Capital gains refers to a profit that results from a disposition of a capital asset, such as stock, bond or real estate, where the amount realized on the disposition exceeds the purchase price.

Capital losses refers to a loss that results from a disposition of a capital asset, such as stock, bond or real estate, where the amount realized on the disposition is less than the purchase price.

Capital gains or losses must be considered when determining effective income, when the individual has a constant turnover of assets resulting in gains or losses.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.58 Capital Gains and Losses (continued)**

Three years' tax returns are required to evaluate an earnings trend. If the trend:

- results in a gain, it may be added as effective income, or
  - consistently shows a loss, it must be deducted from the total income.
- 

### **3.59 Expected Income**

Expected income refers to income from cost-of-living adjustments, performance raises, a new job, or retirement that has not been, but will be received within 60 Days of mortgage closing.

The mortgagee may consider expected income as effective income except when expected income is to be derived from a family-owned business.

The mortgagee must verify and document the existence and amount of expected income with the employer in writing and that it is guaranteed to begin within 60 Days of mortgage closing. For expected retirement income, the mortgagee must verify the amount and that it is guaranteed to begin within 60 Days of the mortgage closing.

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### **3.60 Calculating Expected Income**

Income is calculated in accordance with the standards for the type of income being received. The mortgagee must also verify that the mortgagor will have sufficient income or liquid assets to meet his or her financial obligations between mortgage closing and the beginning of the receipt of the income.

---

### **3.61 Trust Accounts Income**

Trust income refers to income that is regularly distributed to a mortgagor from a trust.

The mortgagee must verify and document the existence of the trust agreement or other trustee statement. The mortgagee must also verify and document the frequency, duration, and amount of the distribution by obtaining a bank statement or transaction history from the bank.

The mortgagee must verify that regular payments will continue for at least the first three years of the mortgage.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.62 Calculating Trust Accounts Income

The mortgagee must use the income based on the terms and conditions in the Trust Agreement or other trustee statement to calculate effective income.

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### 3.63 Annuities or Similar Income

Annuity income refers to a fixed sum of money periodically paid to the mortgagor from a source other than employment.

The mortgagee must verify and document the legal agreement establishing the annuity and guaranteeing the continuation of the annuity for the first three years of the mortgage. The mortgagee must also obtain a bank statement or a transaction history from a bank evidencing receipt of the annuity.

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### 3.64 Calculating Annuities and Similar Income

The mortgagee must use the current rate of the annuity to calculate effective income.

The mortgagee must subtract any of the assets used for the required cash investment for a **HECM for Purchase**, or where the mortgagor is otherwise required to bring cash to closing, from the mortgagor's liquid assets prior to calculating any annuity income.

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### 3.65 Notes Receivable Income

Notes receivable income refers to income received by the mortgagor as payee or holder in due course of a promissory note or similar credit instrument.

The mortgagee must verify and document the existence of the note. The mortgagee must also verify and document the payments have been consistently received for the previous 12 months by obtaining tax returns, deposit slips or canceled checks and that such payments are guaranteed to continue for the first three years of the mortgage.

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### 3.66 Calculating Notes Receivable Income

For mortgagors who have been and will be receiving a consistent amount of notes receivable income, the mortgagee must use the current rate of income to calculate effective income. For mortgagors whose notes receivable income fluctuates, the mortgagee must use the average of the notes receivable income received over the previous year to calculate effective income.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.67 Government Assistance Non- Cash Benefits**

Mortgagees may count as income non-cash benefits being received by the mortgagor through federal, state or local government programs, e.g., Supplemental Nutritional Assistance Program (SNAP), energy assistance, etc. In determining whether such benefits may be counted as income the mortgagee must:

- verify that the benefits are being received at the time of loan application, or that an award letter has been issued, and benefits will begin to be received within 60 days. Mortgagees may not count benefits for which the mortgagor is potentially eligible and intends to apply;
- verify that the benefits are not subject to any stated termination date other than one related to the death of the mortgagor or the sale of the property and
- verify that approval of the HECM will not jeopardize continued eligibility for the benefits, e.g., HECM proceeds would trigger disqualification based on program income or asset requirements.

Some benefit programs may result in a reduction in the mortgagor's expenses rather than increasing their income (e.g., the mortgagor is charged a lower rate for insurance). In these cases, the reduced amount may be used in calculating expenses and must not be treated as income. See Section 3.75 for further information.

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### **3.68 Imputed Income from Asset Dissipation**

Regular income from interest, dividends, or other returns from the mortgagor's investments may be included in the calculation of residual income provided that such income is properly documented. Alternatively, mortgagees may estimate imputed income from dissipation of liquid assets, defined as assets that can be converted to cash within one-year without payment of an IRS penalty, using the applicable discount in the table below

However, mortgagees may not count the same asset twice, i.e., as a source of interest income and as imputed income from the dissipation of the asset. The mortgagee must also subtract any of the assets used for the required cash investment for a HECM for purchase, or where the mortgagor is otherwise required to bring cash to closing, from the mortgagor's liquid assets prior to calculating any imputed income from asset dissipation.

Liquid asset sources from which imputed income may be calculated include, but are not limited to the following

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## Cash Flow/Residual Income Analysis, Continued

### 3.68 Imputed Income from Asset Dissipation (continued)

Asset Source	Amount To Be Counted
Savings and Checking Accounts, Certificates of Deposit, Roth IRAs and any other assets that are not subject to federal taxes.	100%
Other assets that are subject to federal taxes	85% *

\* Mortgagees may use the mortgagor's actual tax rate based on federal tax returns from the prior tax year if tax rate is lower than 15% or no discount if mortgagor does not have a federal tax obligation.

Mortgagees must calculate the combined value of assets and calculate income from these sources. Divide the total adjusted value by the remaining life expectancy of the youngest mortgagor (in months) from Loan period 2 in the Assumed Loan Periods for Computations of Total Annual Loan Cost Rates provided in Appendix 1. If the youngest mortgagor's next birthday is less than 183 days after the estimated date of closing, round up the age to the nearest whole year.

If the asset is jointly held with any other party not obligated for the mortgage, the asset may be counted provided that the mortgagor provides documentation that the mortgagor has unrestricted access to that asset.

### 3.69 Asset Dissipation Calculation Table

Mortgagees must use the table below as a guide to calculating imputed income from liquid assets. The resulting monthly amount should be entered on the financial assessment worksheet to calculate residual income

*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

### 3.69 Asset Dissipation Calculation Table (continued)

Asset Type	Account Value		Value %		Discounted Value
Checking/Savings/Certificates of Deposit/Roth IRA and other assets not subject to federal taxes if dissipated.	\$	x	100%	=	\$
Assets subject to federal taxes if dissipated.	\$	x	Higher of 85% or { 100% minus applicable Federal tax rate }		
Total Discounted Value					\$
minus mortgagor funds needed to close					-
Adjusted Discounted Value					\$
Life Expectancy of Youngest Mortgagor, with age rounded up to the nearest whole year if the next birthday is less than 183 days after the estimated date of closing, In Months Life Expectancy in Years _____ x 12 =					mos.
Adjusted Discounted Value ÷ Life Expectancy in months = Total Monthly Income from Assets					\$

Where monthly income from asset dissipation is included in the residual income analysis mortgagees must attach documentation to the financial assessment worksheet identifying the specific assets used and the calculation of the monthly amount.

### 3.70 Assets – Checking and Savings Accounts

Checking and savings accounts refer to funds from mortgagor-held accounts in a financial institution that allows for withdrawals and deposits.

To be considered as part of the financial assessment, mortgagees must verify and document the existence of and amounts in the mortgagor's checking and savings accounts.

If the mortgagor does not hold the deposit account solely, all non-mortgagor parties on the account must provide a written statement that the mortgagor has full access to and use of the funds.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.70** **Assets –** **Checking and** **Savings** **Accounts** (continued)

The mortgagee must obtain a written verification of deposit (VOD) and the mortgagor's most recent statement for each account.

If a VOD is not obtained, a statement showing the previous month's ending balance for the most recent month is required. If the previous month's balance is not shown, the mortgagee must obtain statement(s) for the most recent two months.

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### **3.71** **Assets –** **Cash On Hand**

Cash on hand refers to cash held by the mortgagor outside of a financial institution.

The mortgagee must verify that the mortgagor's cash on hand is deposited in a financial institution or held by the escrow/title company.

The mortgagee must verify and document the mortgagor's cash on hand by obtaining an explanation from the mortgagor describing how the funds were accumulated and the amount of time it took to accumulate the funds.

The mortgagee must also determine the reasonableness of the accumulation based on the time period during which the funds were saved and the mortgagor's:

- income stream;
  - spending habits;
  - documented expenses; and
  - history of using financial institutions.
- 

### **3.72** **Assets -** **Retirement** **Accounts**

Retirement accounts refer to assets accumulated by the mortgagor for the purpose of retirement.

The mortgagee must obtain the most recent monthly or quarterly statement to verify and document the existence and amounts in the mortgagor's retirement accounts, the mortgagor's eligibility for withdrawals, and the terms and conditions for withdrawal from any retirement account.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.73

#### Assets – Stocks and Bonds

Stocks and bonds are investment assets accumulated by the mortgagor.

The mortgagee must determine the value of stocks and bonds from the most recent monthly or quarterly statement.

If the stocks and bonds are not held in a brokerage account, the mortgagee must determine the current value of the stocks and bonds through third party verification. Government-issued savings bonds are valued at the original purchase price, unless the mortgagee verifies and documents that the bonds are eligible for redemption.

The mortgagee must verify and document the existence of the mortgagor's stocks and bonds by obtaining brokerage statement(s) for each account for the most recent two months. Evidence of liquidation is not required.

For stocks and bonds not held in a brokerage account the mortgagee must obtain a copy of each stock or bond certificate.

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### 3.74

#### Assets – Private Savings Clubs

Private savings clubs refer to a non-traditional method of saving by making deposits into a member-managed resource pools. The mortgagee may consider private savings club funds that are distributed to and received by the mortgagor as an acceptable source of funds.

The mortgagee must verify and document the establishment and duration of the club, and the mortgagor's receipt of funds from the club. The mortgagee must also determine that the received funds were reasonably accumulated, and not borrowed.

The mortgagee must obtain the club's account ledgers and receipts, and verification from the club treasurer that the club is still active.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.75 Expense Analysis**

Using the credit report, Fannie Mae Form 1009, Part VI of URLA or equivalent, most recent Federal and state income tax returns, and other documents that may be available to the mortgagee (e.g., bank statements), the mortgagee must identify all secured and unsecured debts. The mortgagee must calculate:

- federal and state income taxes;
- FICA;
- property charges for the subject property;
- estimated utility and maintenance expenses;
- installment account payments;
- any other owned property mortgage obligations (debt and property charges);
- revolving credit account payments;
- alimony and child support payments;
- judgments under payment plans against the mortgagor;
- payments required under any bankruptcy plans; and
- other obligations described in this Guide.

Where the mortgagor benefits from federal, state or local benefit programs that reduce mortgagor expenses, the reduced amounts may be used to calculate expenses provided that the mortgagee complies with the requirements of Section 3.67.

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### **3.76 Liens Paid Off Using HECM Proceeds**

Where a lien against the property, such as a mortgage, is being paid off with HECM proceeds, the monthly payment associated with that lien is not included in the expense analysis.

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### **3.77 General Liabilities and Debts**

The mortgagee must determine the mortgagor's monthly liabilities by reviewing all debts listed on the credit report, Part VI of URLA or equivalent, tax returns, bank statements, and pay stubs. The mortgagee must document the reasons for exclusion of any debt listed on these documents.

All applicable monthly liabilities must be included in the expense analysis. Closed-end debts do not have to be included if they will be paid off within 10 months and the cumulative payments of all such debts are less than or equal to 5 percent of the mortgagor's gross monthly income. The mortgagor may not pay down the balance in order to meet the 10-month requirement.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.77 General Liabilities and Debts (continued)**

Accounts for which the mortgagor is an authorized user must be included in an expense analysis unless the mortgagee can document that the primary account holder has made all required payments for the previous 12 months. If less than three payments have been required on the account, the payment amount must be included in the mortgagor's expenses.

Negative income must be subtracted from the mortgagor's gross monthly income, and not treated as a recurring monthly liability unless otherwise noted.

Loans secured against deposited funds, where repayment may be obtained through extinguishing the asset and these funds are not included in calculating the mortgagor's assets, do not require consideration in the expense analysis.

---

### **3.78 Undisclosed Debts and Inquiries**

When a debt or obligation is revealed during the application process that was not listed on the mortgage application and/or credit report, the mortgagee must:

- verify the actual monthly payment amount; and
- include the payment amount in the agreement in the expense analysis;

The mortgagee must obtain a written explanation from the mortgagor for all inquiries shown on the credit report that were made in the last 90 Days. The mortgagee must document all undisclosed debt and support for its analysis of the mortgagor's debt.

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### **3.79 Federal Debt**

Federal debt refers to non-delinquent debt owed to the federal government for which regular payments are being made.

The amount of the required payment must be included in the expense analysis.

The mortgagee must include documentation from the federal agency evidencing the repayment agreement and verification of payments made, if applicable.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.80 Alimony, Child Support and Maintenance**

Alimony, child support, and other maintenance are court-ordered or otherwise agreed upon payments.

For alimony, if the mortgagor's income was not reduced by the amount of the monthly alimony obligation in the mortgagee's calculation of the mortgagor's gross income, the mortgagee must verify and include the monthly obligation in its calculation of the mortgagor's debt.

Child support and other maintenance are to be treated as a recurring liability and the mortgagee must include the monthly obligation in the expense analysis.

The mortgagee must obtain the official signed divorce decree, separation agreement, maintenance agreement, or other legal order. The mortgagee must also obtain the mortgagor's pay stubs covering no less than 28 consecutive days to verify whether the mortgagor is subject to any order of garnishment relating to the alimony, child support, or other maintenance.

The mortgagee must calculate the mortgagor's monthly obligation from the greater of:

- the amount shown on the most recent decree or agreement establishing the mortgagor's payment obligation; or
- the monthly amount of the garnishment.

---

### **3.81 Deferred Obligations**

Deferred obligations (excluding student loans) refer to liabilities that have been incurred but where payment is deferred or has not yet commenced, including accounts in forbearance. The mortgagee must verify and include deferred obligations in the expense analysis.

The mortgagee must obtain written documentation of the deferral of the liability from the creditor and evidence of the outstanding balance and terms of the deferred liability. The mortgagee must obtain evidence of the anticipated monthly payment obligation, if available.

The mortgagee must use the actual monthly payment to be paid on a deferred liability, whenever available. If the actual monthly payment is not available for installment debt, the mortgagee must utilize the terms of the debt or 5 percent of the outstanding balance to establish the monthly payment.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### **3.82 Installment Loans**

Installment loans (excluding student loans) refer to loans, not secured by real estate, that require the periodic payment of principal and interest. A loan secured by an interest in a timeshare must be considered an installment loan.

The mortgagee must include the monthly payment shown on the credit report, loan agreement or payment statement in the expense analysis.

If the credit report does not include a monthly payment for the loan, the mortgagee must use the amount of the monthly payment shown in the loan agreement or payment statement.

If the monthly payment shown on the credit report is utilized to calculate the monthly debts, no further documentation is required.

If the credit report does not include a monthly payment for the loan, or the payment reported on the credit report is greater than the payment on the loan agreement or payment statement, the mortgagee must obtain a copy of the loan agreement or payment statement documenting the amount of the monthly payment. If the credit report, loan agreement, or payment statement shows a deferred payment arrangement for an installment loan, refer to Section 3.80.

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### **3.83 Student Loans**

Student loan refers to liabilities incurred for educational purposes. The mortgagee must include all student loans in the expense analysis, regardless of the payment type or status of payments.

If the payment used for the monthly obligation is:

- less than 1 percent of the outstanding balance reported on the mortgagor's credit report, and
- less than the monthly payment reported on the mortgagor's credit report;

the mortgagee must obtain written documentation of the actual monthly payment, the payment status, and evidence of the outstanding balance and terms from the creditor.

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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### 3.83 Student Loans (continued)

Regardless of the payment status, the mortgagee must use either:

- the greater of:
    - 1 percent of the outstanding balance on the loan; or
    - the monthly payment reported on the mortgagor's credit report; or
  - the actual documented payment, provided the payment will fully amortize the loan over its term.
- 

### 3.84 Revolving Charge Accounts

A revolving charge account refers to a credit arrangement that requires the mortgagor to make periodic payments but does not require full repayment by a specified point of time.

The mortgagee must include in the expense analysis the monthly payment shown on the credit report for the revolving charge account. Where the credit report does not include a monthly payment for the account, the mortgagee must use the payment shown on the current account statement or 5 percent of the outstanding balance.

The mortgagee must use the credit report to document the terms, balance and payment amount on the account, if available.

Where the credit report does not reflect the necessary information on the charge account, the mortgagee must obtain a copy of the most recent charge account statement or use 5 percent of the outstanding balance to document the monthly payment.

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### 3.85 30 Day Accounts

30-Day accounts refer to a credit arrangement that requires the mortgagor to pay the outstanding balance on the account every month.

The mortgagee must verify the mortgagor pays the outstanding balance in full on every 30-Day account each month for the past 12 months. 30-Day accounts that are paid monthly are not included in the expense analysis. If the credit report reflects any late payments in the last 12 months, the mortgagee must utilize 5 percent of the outstanding balance as the mortgagor's monthly debt to be included in the expense analysis.

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## Cash Flow/Residual Income Analysis, Continued

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**3.85**  
**30 Day**  
**Accounts**  
(continued)

The mortgagee must use the credit report to document that the mortgagor has paid the balance on the account monthly for the previous 12 months. The mortgagee must use the credit report to document the balance, and must document sufficient funds in excess of any funds required to close the HECM are available to pay off the balance.

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**3.86**  
**Business Debt**  
**in Mortgagor's**  
**Name**

Business debt in mortgagor's name refers to liabilities reported on the mortgagor's personal credit report, but payment for the debt is attributed to the mortgagor's business.

When business debt is reported on the mortgagor's personal credit report, the debt must be included in the expense analysis, unless the mortgagee can document that the debt is being paid by the mortgagor's business, and the debt was considered in the cash-flow analysis of the mortgagor's business. The debt is considered in the cash flow analysis where the mortgagor's business tax returns reflect a business expense related to the obligation, equal to or greater than the amount of payments documented as paid out of company funds. Where the mortgagor's business tax returns show an interest expense related to the obligation, only the interest portion of the debt is considered in the cash flow analysis.

When a self-employed mortgagor states that debt appearing on their personal credit report is being paid by their business, the mortgagee must obtain documentation that the debt is paid out of company funds and that the debt was considered in the cash-flow analysis of the mortgagor's business

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**3.87**  
**Disputed**  
**Derogatory**  
**Accounts**

Disputed derogatory credit accounts refer to disputed charge off accounts, disputed collection accounts, and disputed accounts with late payments in the last 24 months.

If the mortgagor has \$1,000 or more collectively in disputed derogatory credit accounts, the mortgagee must include a monthly payment in the expense analysis.

The following items are excluded from the expense analysis:

- disputed medical accounts; and
  - disputed derogatory credit resulting from identity theft, credit card theft or unauthorized use.
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*Continued on next page*

## Cash Flow/Residual Income Analysis, Continued

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### 3.88 Non-Derogatory Disputed Account and Disputed Accounts Not Indicated on the Credit Report

Non-Derogatory disputed accounts include the following types of accounts:

- disputed accounts with zero balance
- disputed accounts with late payments aged 24 months or greater
- disputed accounts that are current and paid as agreed

If a mortgagor is disputing non-derogatory accounts, or is disputing accounts which are not indicated on the credit report as being disputed, the mortgagee must analyze the effect of the disputed accounts in the expense analysis. If the dispute results in monthly payments being less than the amount indicated on the credit report, the mortgagor must provide documentation of the lower payment.

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### 3.89 Contingent Liabilities

A contingent liability is a liability that may result in the obligation to repay only where a specific event occurs. For example, a contingent liability exists when an individual can be held responsible for the repayment of a debt if another legally obligated party defaults on the payment. Contingent liabilities may include cosigner liabilities and liabilities resulting from a mortgage assumption without release of liability.

The mortgagee must include monthly payments on contingent liabilities in the expense analysis unless the mortgagee verifies that there is no possibility that the debt holder will pursue debt collection against the mortgagor should the other party default, or the other party has made 12 months of timely payments.

#### **Mortgage Assumptions**

The mortgagee must obtain the agreement creating the contingent liability or assumption agreement and deed showing transfer of title out of the mortgagor's name.

#### **Cosigned Liabilities**

If the cosigned liability is not included in the monthly obligation, the mortgagee must obtain documentation to evidence that the other party to the debt has been making regular on-time payments during the previous 12 months, and does not have a history of delinquent payments on the loan.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.89 Contingent Liabilities (continued)

#### **Court Ordered Divorce Decree**

The mortgagee must obtain a copy of the divorce decree ordering the spouse to make payments.

#### **Calculation of Monthly Obligation**

The mortgagee must calculate the monthly payment on the contingent liability based on the terms of the agreement creating the contingent liability.

---

### 3.90 Collection Accounts

A collection account is a mortgagor's loan or debt that has been submitted to a collection agency by a creditor.

If the credit reports used in the analysis show cumulative outstanding collection account balances of \$2,000 or greater, the mortgagee must:

- verify that the debt is paid in full at the time of or prior to settlement using an acceptable source of funds;
- verify that the mortgagor has made payment arrangements with the creditor; or
- if a payment arrangement is not available, calculate the monthly payment using 5 percent of the outstanding balance of each collection and include the monthly payment in the expense analysis.

The mortgagee must provide the following documentation:

- evidence of payment in full, if paid prior to settlement;
- the payoff statement, if paid at settlement; or
- the payment arrangement with creditor, if not paid prior to or at settlement.

If the mortgagee uses 5 percent of the outstanding balance no documentation is required

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## Cash Flow/Residual Income Analysis, Continued

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### **3.91 Charge Off Accounts**

A charge off account refers to a mortgagor's loan or debt that has been written off by the creditor.

Charge off accounts do not need to be included in the mortgagor's expenses.

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### **3.92 Private Savings Clubs**

Private savings clubs refers to non-traditional methods of saving by making deposits into a member-managed resource pool.

If the mortgagor is obligated to continue making ongoing contributions under the pooled savings agreement, this obligation must be included in the expense analysis.

The mortgagee must verify and document the establishment and duration of the mortgagor's membership in the club and the amount of the mortgagor's required contribution to the club. The mortgagee must also obtain the club's ledgers and receipts, and verification from the club treasurer that the club is still active.

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### **3.93 Federal and State Income Taxes**

Mortgagees may use current pay stubs, tax tables, or federal, state and local tax returns from the most recent tax year, to document federal, state and local taxes.

If the mortgagor's most recent tax return is more than two years old, the mortgagee must estimate current taxes using available guidance and tax tables.

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### **3.94 Maintenance and Utility Charges**

Mortgagees may rely on the formula established by Department of Veterans Affairs (VA) for estimated maintenance and utilities in all states. Mortgagees should multiply the living area of the property (square feet) by \$0.14.

Mortgagees must use the figure for square feet from the Improvements section on page 1 of the appraisal under Square Feet of Gross Living Area Above Grade.

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## Cash Flow/Residual Income Analysis, Continued

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### 3.95 Documentation Standards for Property Charges

Mortgagees must verify and document the amount of property charges in accordance with the following requirements:

- *Property Taxes.* Mortgagees must document the amount of property taxes due from all taxing authorities through written statements or on-line print-outs from the taxing authorities, or through copies of bills. See Section 2.27 for information on property tax waivers or deferrals.
- *Homeowners/Hazard Insurance.* Mortgagees must obtain the current year's declaration sheet of the insurance policy. Where no homeowners/hazard insurance policy was previously in place, mortgagees shall base the cost of homeowners/hazard insurance upon the insurance quote provided to the mortgagor for the cost of homeowners/hazard insurance under the HECM.
- *Flood Insurance.* Mortgagees must obtain the current year's declaration sheet of the insurance policy. Where no flood insurance policy was previously in place, mortgagees shall base the cost of flood insurance upon the insurance quote provided to the mortgagor for the cost of flood insurance under the HECM.
- *HOA, PUD and Condominium Fees.* Mortgagees must obtain from the appraisal, or from a written statement from the association or its management agent, documentation on the amount of the monthly fees.
- *Other Assessments.* Mortgagees must obtain from the party levying the assessment or its management agent a written statement documenting the amount of any other assessments.
- *Ground Rents.* Mortgagees must obtain from the deed, the lessor or its management agent a written statement documenting the amount of the ground rent payment.

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### 3.96 Expense Analysis for an Eligible Non- Borrowing Spouse

Mortgagees must analyze an Eligible Non-Borrowing Spouse's obligations from the sources specified in Section 3.75 if an Eligible Non-Borrowing Spouse's income is used as a Compensating Factor or to reduce family size.

The Eligible Non-Borrowing Spouse's expenses must meet the same documentation and verification standards as required for the mortgagor's expenses.

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## Cash Flow/Residual Income Analysis, Continued

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### **3.97 Expense Analysis for Other Non- Borrowing Household Members**

Mortgagees must analyze an Other Non-Borrowing Household Member's obligations from the sources specified in Section 3.75 if his or her income is to be used to reduce family size.

The Other Non-Borrowing Household Member's expenses must meet the same documentation and verification standards as required in this Guide for the mortgagor's expenses.

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### **3.98 Property Taxes as a Percentage of Gross Income**

FHA has identified situations where property taxes exceed 10% of the mortgagor's gross income as carrying greater levels of risk of default. Mortgagees must calculate property taxes as a percentage of gross income and enter this figure on the Financial Assessment Worksheet.

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### **3.99 Residual Income**

The mortgagor's residual income is calculated by summing the total monthly income from all sources for the mortgagors obligated on the mortgage, and subtracting from that amount the total monthly expenses from all sources for the mortgagors obligated on the mortgage.

The mortgagee's analysis must be entered on a financial assessment worksheet that identifies the specific amounts and sources of income and expenses determined through the cash flow/residual income analysis.

Count all members of the household (without regard to the nature of the relationship) when determining "family size," including an Eligible Non-Borrowing Spouse and Other Non-Borrowing Household Members.

The mortgagee may omit an Eligible Non-Borrowing Spouse and/or an Other Non-Borrowing Household Member from family size provided that their residual income is equal to or exceeds the income required for a one person family size for the geographic area in which the property is located

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## Cash Flow/Residual Income Analysis, Continued

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### 3.99 Residual Income (continued)

The 1 person family size may only be used:

- for a mortgagor where Fannie Mae Form 1009, *Residential Loan Application for Reverse Mortgages*, indicates that the mortgagor is single or unmarried;
- for mortgagors required to file tax returns, the results of a Form 4506-T, *Request for Transcript or Tax Return*, or verification or copies of tax returns confirm that the mortgagor files as a single person, or, for mortgagors not required to file tax returns, the property title, credit report, or other information supports the marital status claimed by the mortgagor; and
- for a mortgagor who identifies him or herself as unmarried in the certification regarding marital status.

This documentation is not required where the Eligible Non-Borrowing Spouse or Other Non-Borrowing Household Member has been excluded from household size based on the criteria defined in this section.

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### 3.100 Residual Income Table

To determine if monthly residual income is sufficient to demonstrate the financial capacity of the mortgagors to meet their financial obligations, select the applicable family size, and region from the table below.

Table of Residual Incomes by Region				
Family Size	Northeast	Midwest	South	West
1	\$ 540	\$ 529	\$ 529	\$ 589
2	\$ 906	\$ 886	\$ 886	\$ 998
3	\$ 946	\$ 927	\$ 927	\$1,031
4 or more	\$1,066	\$1,041	\$1,041	\$1,160

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## Cash Flow/Residual Income Analysis, Continued

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### 3.101 States Included in Regions

The Regions on the Table of Residual Income include the following states:

Region	States
Northeast	CT, MA, ME, NH, NJ, NY, PA, RI, VT
Midwest	IA, IL, IN, KS, MI, MN, MO, ND, NE, OH, SD, WI
South	AL, AR, DC, DE, FL, GA, KY, LA, MD, MS, NC, OK, PR, SC, TN, TX, VA, VI, WV
West	AK, AZ, CA, CO, HI, ID, MT, NM, NV, OR, UT, WA, WY

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### 3.102 Model Financial Assessment Worksheet

Mortgagees may use the model HECM Financial Assessment Worksheet or develop their own worksheet, provided the required information on credit history, income and expenses, and the calculation of residual income is captured. The Model Financial Assessment Worksheet is available on FHA's HECM For Lenders site under *HUD Model Loan Documents* at [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/sfh/model\\_documents](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/model_documents)

Mortgagees must also document the calculation of imputed income and maintenance and utility expenses, and identify and document any Extenuating Circumstances or Compensating Factors it relied upon in making its determination.

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# Extenuating Circumstances and Compensating Factors

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## 4.1 Extenuating Circumstances

Where the mortgagor's credit and/or property charge payment history does not meet the criteria described in Sections 2.15 and 2.28, mortgagees must consider any Extenuating Circumstances that led to the credit or property charge issues.

Extenuating Circumstances may include, but are not limited to:

- loss of income due to the death or divorce of a spouse that directly resulted in late payment of obligations;
- loss of income due to the mortgagor's or spouse's unemployment, reduced work hours or furloughs, or emergency medical treatment or hospitalization that directly resulted in late payments of obligations; or
- increase in financial obligations due to emergency medical treatment or hospitalization for the mortgagor or spouse, emergency property repairs not covered by homeowners or flood insurance, divorce, or other causes that directly resulted in late payments of obligations.

Mortgagees must document the presence of any Extenuating Circumstances as part of the financial assessment. In order to be used to make a determination that credit and/or property charge payment history is acceptable, documentation of Extenuating Circumstances must demonstrate:

- the connection between the specific occurrence(s) and the measurable impact of the occurrence(s) on the mortgagor's finances;
- that no other actions, not directly or indirectly related to the financial problem, were taken by the mortgagor that contributed to the derogatory incident(s) (e.g., assuming new financial obligations, voluntarily terminating employment or reducing hours, etc.);
- the likelihood that these circumstances will not recur. In assessing the likelihood that the circumstances will not recur, mortgagees may consider the impact of the HECM on the mortgagor's circumstances, through the elimination of financial obligations and/or through an increase in mortgagor income; and
- that the mortgagor demonstrates financial liquidity through non-HECM assets, additional sources of income, access to revolving credit or other factors that enhance his or her ability to endure financial challenges.

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## Extenuating Circumstances and Compensating Factors,

Continued

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### 4.2 Extenuating Circumstances- Unemployment

If a mortgagor cited loss of income due to unemployment as the cause of late payments or other derogatory information, the documentation must include the following:

- the mortgagor had documented satisfactory credit and/or property charge payment history prior to being unemployed;
- the mortgagor's documented income, including any unemployment compensation received, was insufficient to make timely payments on all outstanding accounts;
- the credit report indicates that the mortgagor did not incur new debt, unrelated to the financial problem, that contributed to the mortgagor's inability to meet all obligations in a timely manner; and
- the mortgagor is employed again and/or has alternate sources of income.

Documentation includes the credit report, W-2s, tax returns, statements from the mortgagor and any additional documentation required to support the loss of income, impact on credit history and recovery.

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### 4.3 Compensating Factors

Where the mortgagor's residual income does not meet the applicable standard in Section 3.100, the mortgagee may consider Compensating Factors.

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### 4.4 Compensating Factors - Other Sources of Income

Income from the sources described below may be cited as a Compensating Factor where (a) the mortgagor's residual income, combined with documented income from one or more of these sources, equals or exceeds the applicable amount for his or her family size and geographic region on the Table of Residual Income in Section 3.100 and (b) the mortgagee can document that the specific criteria described for the individual Compensating Factor has been met.

- **Eligible Non-Borrowing Spouse Income**  
Mortgagor has documented residual income from an Eligible Non-Borrowing Spouse;
- **Overtime, Seasonal, Part-time or Bonus Income**  
Mortgagor has documented overtime, bonus, part-time or seasonal income that the mortgagor has received for at least six months and it will likely continue;

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## Extenuating Circumstances and Compensating Factors, Continued

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### 4.4 Compensating Factors - Other Sources of Income (continued)

- **Expected SSI or Pension Income**  
The mortgagor has received an award letter stating that the mortgagor will begin receiving pension or Social Security income within the next 12 months;
  - **Imputed Income from HECM**  
An increase in monthly income would result from dissipating available HECM proceeds remaining after closing (based on original principal limit less required Repair, Life Expectancy and Servicing Set-Asides and disbursements for Mandatory Obligations).
- 

### 4.5 Compensating Factors – Other Resources

The following Compensating Factors may be cited where (a) the mortgagor's residual income is 80%-99% of the applicable amount for his or her family size and geographic region on the Table of Residual Income in Section 3.100 and (b) the mortgagee can document that the specific criteria described for the individual Compensating Factor has been met.

- **Property Charge Payment History**  
The mortgagor meets all of the following:
    - mortgagor has paid his or her own property charges directly for at least the last 24 months (i.e., they were not paid by a mortgagee from an escrow account or by another party) and meets the standard in Section 2.28;
    - mortgagor has made all property charge payments without incurring penalties during the last 24 months; and
    - mortgagor current income is not less than income during the previous 24 months
  - **Assets Equal to Life Expectancy Property Charges**  
The mortgagor has assets (excluding HECM proceeds) equivalent to the anticipated property charge payments for the life expectancy of the mortgagor that were not dissipated or considered in the residual income calculation;
  - **HECM Sufficient To Pay Off Debts**  
HECM proceeds remaining after closing (based on original principal limit less required Repair, Life Expectancy and Servicing Set-Asides and disbursements for Mandatory Obligations) that were not dissipated and counted as income, are sufficient to pay off revolving and installment debt, including revolving and installment accounts in collection, that would reduce monthly payments to the extent that residual income would meet or exceed the applicable standard for his or her family size and geographic region on the Table of Residual Income in Section 3.100; and
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## Extenuating Circumstances and Compensating Factors, Continued

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### **4.5 Compensating Factors – Other Resources (continued)**

- **Access to Other Credit**

The Mortgagor has access to revolving credit that provide the mortgagor with financial liquidity that would enhance his or her ability to endure a financial hardship.

The credit report shows established credit lines, other than his or her housing payment, in the mortgagor's name open for at least six months; and the mortgagor can document that these accounts have been paid off in full monthly for at least the past six months.

Mortgagors who have no established credit other than their housing payment, no other credit lines in their own name open for at least six months, or who cannot document that all other accounts are paid off in full monthly for at least the past six months, do not qualify under this criterion. Credit lines not in the mortgagor's name but for which he or she is an authorized user do not qualify under this criterion.

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### **4.6 Documenting Extenuating Circumstances, Compensating Factors**

Mortgagees must document any Extenuating Circumstances to address derogatory credit and/or property charge payment history, and/or Compensating Factors to support residual income shortfalls.

The mortgagee must identify in writing on the Financial Assessment Worksheet all specific circumstances and factors it relied upon to make its favorable determination. Supporting documentation must be included in the origination case binder.

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# Property Charge Funding Requirements

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## **5.1 Life Expectancy Set- Aside**

A Life Expectancy Set-Aside (LESA) is an amount withheld from the mortgage proceeds for the payment of property charges during the life of the mortgagor. The need for a LESA, the funding amount of the LESA, and the structure of the LESA, are based on the results of the financial assessment of the mortgagor

Where the mortgagee determines, after considering any documented Extenuating Circumstances and Compensating Factors, that the mortgagor has demonstrated the willingness and the capacity to meet his or her obligations, a LESA is not required. Where the mortgagee determines that the mortgagor has not demonstrated the willingness and/or the capacity to meet his or her obligations, a LESA is required.

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## **5.2 Projected Life Expectancy Property Charges**

Mortgagees must calculate the Projected Life Expectancy Property Charge Cost for all HECMs, whether a LESA is required or not. The formula for calculating the Projected Life Expectancy Property Charge Cost includes:

- the projected sum of:
    - current property taxes;
    - homeowners insurance premiums; and
    - flood insurance premiums.
  - a factor to reflect increases in tax and insurance rates;
  - the HECM expected average mortgage interest rate; and
  - the life expectancy of the youngest mortgagor, with mortgagor age rounded up to the nearest whole year if the next birthday is less than 183 days after the estimated date of closing (see Section 5.8).
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## Property Charge Funding Requirements, Continued

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### 5.3 Projected Life Expectancy Property Charges Cost Formula

#### **FORMULA FOR CALCULATING PROJECTED LIFE EXPECTANCY PROPERTY CHARGE COST**

$$\text{Projected Life Expectancy Property Charge Cost} = (1.2 \times \text{PC} \div 12) \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^m\}$$

**PC (Property Charges) ÷ 12** is the current total monthly Property Charge for property taxes, homeowners insurance and flood insurance.

**m** is the Total Annual Loan Cost (TALC) life expectancy in years of the youngest mortgagor, with mortgagor age rounded up to the nearest whole year if the next birthday is less than 183 days after the estimated date of closing, x 12 (e.g., for a 74 year old mortgagor whose birthday is more than 183 days after the estimated date of closing, TALC life expectancy is 12 years x 12 months = 144).

**c** is the monthly compounding rate which is defined as the expected rate plus the annual Mortgage Insurance Premium (MIP) rate ÷ 12.

The **PC ÷ 12** is multiplied by 1.2 to take into account expected increases in property taxes and hazard and flood insurance over the life expectancy of the youngest mortgagor.

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### 5.4 Life Expectancy Set- Aside Must Be Fully Funded

Where the mortgagee determines, after considering any documented Extenuating Circumstances, that the mortgagor has not demonstrated the willingness to meet his or her financial obligations, i.e. credit history and/or property charge payment history is not acceptable, the LESA must be fully funded.

Through the Fully Funded LESA the mortgagee will use HECM proceeds to pay property taxes and insurance premiums on behalf of the mortgagor. The mortgagor remains responsible for all other property charges.

Where the Fully Funded LESA is required or voluntarily requested by the mortgagor, the amount of the required Set-Aside equals the Projected Life Expectancy Property Charge Cost calculated in accordance with the formula in Section 5.3.

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## Property Charge Funding Requirements, Continued

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### 5.5 Life Expectancy Set- Aside Must Be Partially Funded

Where the mortgagee determines, after considering any documented Compensating Factors, that the mortgagor has demonstrated the willingness to meet his or her financial obligations but does not meet the residual income requirements, the LESA must be partially funded (unless the mortgagor has voluntarily requested a Fully Funded LESA).

Through the Partially-Funded LESA the mortgagor will receive semi-annual payments from HECM proceeds to be used to pay property taxes and insurance premiums. The mortgagor remains responsible for timely payment of all property charges.

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### 5.6 Partially Funded Life Expectancy Set- Aside Formula

When a LESA is partially funded, the amount of the required set-aside shall be calculated based on the following formula.

#### **FORMULA FOR CALCULATING PARTIALLY FUNDED LESA**

Partially Funded LESA =

$$(1.2 \times \text{MRIS}) \times \{(1 + c)^{m+1} - (1 + c)\} \div \{c \times (1 + c)^m\}$$

**MRIS** (**M**onthly **R**esidual **I**ncome **S**hortfall) is the residual income gap - the difference between the mortgagor's monthly residual income, and the applicable amount of residual income for the mortgagor's geographic region and family size, based on the Table of Residual Income in Section 3.82.

**m** is the TALC life expectancy in years of the youngest mortgagor, with mortgagor age rounded up to the nearest whole year if the next birthday is less than 183 days after the estimated date of closing, x 12 (e.g., for a 75 year old mortgagor whose birthday is less than 183 days from the estimated date of closing, TALC life expectancy is 11 years x 12 months = 132).

**c** is the monthly compounding rate which is defined as the expected rate plus the annual mortgage insurance premium (MIP) rate ÷ 12.

The **MRIS** is multiplied by 1.2 to take into account expected increases in property taxes and hazard and flood insurance over the life expectancy of the youngest mortgagor.

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## Property Charge Funding Requirements, Continued

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### 5.7 Additional Requirement for Use of Partially Funded Life Expectancy Set- Aside

Where the projected Partially Funded LESA is greater than 75% of the Projected Life Expectancy Property Charge Cost, the mortgagor is not eligible for a Partially Funded LESA. The mortgagee must require, as a condition of mortgage approval, a Fully Funded LESA.

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### 5.8 Life Expectancy Table

The figure used for life expectancy is taken from the U.S. Decennial Life Tables for 1979-1981 females found at Title 12, Appendix L. The life expectancy figures to be used are provided in Appendix 1 in the fourth column titled Loan Period 2 (life expectancy) (in years). Mortgagees must select the age of the youngest mortgagor (rounded up to the nearest whole year if the next birthday is less than 183 days after the estimated date of closing) and use the corresponding life expectancy figure found in the fourth column of the table for the mortgagor's life expectancy.

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### 5.9 Life Expectancy Set- Aside and Loan Decision

When determining the need for a LESA, and whether the HECM represents a sustainable solution for the mortgagor's financial circumstances, the mortgagee must evaluate whether the mortgagor meets residual income, credit history and property charge history requirements including the use, of Extenuating Circumstances, and Compensating Factors.

The mortgagee must determine if a LESA is required based on the following:

- **Credit History**  
If, after considering any applicable Extenuating Circumstances, the mortgagor's credit is not acceptable, a Fully Funded LESA must be required if the HECM is to be approved.
  - **Property Charge Payment History**  
If, after considering any applicable Extenuating Circumstances, the mortgagor's Property Charge Payment History is not acceptable, a Fully Funded LESA must be required if the HECM is to be approved.
  - **Residual Income**  
If, after considering any applicable Compensating Factors, the mortgagor's residual income is not sufficient to meet the mortgagor's needs:
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## Property Charge Funding Requirements, Continued

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### 5.9 Life Expectancy Set- Aside and Loan Decision (continued)

- A Partially Funded LESA must be required if the amount of the Partially Funded LESA is less than or equal to 75% of the Projected Life Expectancy Property Charge Cost (unless the mortgagor has voluntarily requested a Fully Funded LESA); or
- A Fully Funded LESA must be required if the amount of the Partially Funded LESA is greater than 75% of the Projected Life Expectancy Property Charge Cost.

In making the loan decision the mortgagee must take into account the impact of a Fully Funded LESA or Partially Funded LESA on the mortgagor's residual income.

There will be an effective reduction in the mortgagor's out-of-pocket monthly expenses where the mortgagee will pay property charges out of HECM proceeds. Where this reduction in expenses would result in the mortgagor effectively meeting the applicable standard for the mortgagor's family size and geographic region in the Table of Residual Income in Section 3.100, it may provide a basis on which to determine the HECM does represent a sustainable solution for the mortgagor's financial circumstances.

Where the amount of property charges to be paid through the Fully Funded LESA is such that the mortgagor will still fall significantly short of the residual income standard, the approval of a HECM, even with a Fully Funded LESA, may not represent a sustainable solution for the mortgagor's financial circumstances.

Mortgagees are reminded that it is their responsibility to provide well documented reasons for the amount by which a LESA has been funded and for approving the HECM when mortgagors do not meet HECM residual income, property charge payment history, and credit history standards, and other financial assessment policies.

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## Appendix 1 - Appendix L to Part 1026—Assumed Loan Periods for Computations of Total Annual Loan Cost Rates

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(a) Required tables. In calculating the total annual loan cost rates in accordance with appendix K of this part, creditors shall assume three loan periods, as determined by the following table.

(b) Loan periods. (1) Loan Period 1 is a two-year loan period.

(2) Loan Period 2 is the life expectancy in years of the youngest borrower to become obligated on the reverse mortgage loan, as shown in the U.S. Decennial Life Tables for 1979-1981 for females, rounded to the nearest whole year.

(3) Loan Period 3 is the life expectancy figure in Loan Period 3, multiplied by 1.4 and rounded to the nearest full year (life expectancy figures at .5 have been rounded up to 1).

(4) At the creditor's option, an additional period may be included, which is the life expectancy figure in Loan Period 2, multiplied by .5 and rounded to the nearest full year (life expectancy figures at .5 have been rounded up to 1).

Age of youngest borrower	Loan period 1 (in years)	[Optional loan period (in years)]	Loan period 2 (life expectancy) (in years)	Loan period 3 (in years)
62	2	[11]	21	29
63	2	[10]	20	28
64	2	[10]	19	27
65	2	[9]	18	25
66	2	[9]	18	25
67	2	[9]	17	24
68	2	[8]	16	22
69	2	[8]	16	22
70	2	[8]	15	21
71	2	[7]	14	20
72	2	[7]	13	18
73	2	[7]	13	18
74	2	[6]	12	17
75	2	[6]	12	17
76	2	[6]	11	15
77	2	[5]	10	14



Age of youngest borrower	Loan period 1 (in years)	[Optional loan period (in years)]	Loan period 2 (life expectancy) (in years)	Loan period 3 (in years)
78	2	[5]	10	14
79	2	[5]	9	13
80	2	[5]	9	13
81	2	[4]	8	11
82	2	[4]	8	11
83	2	[4]	7	10
84	2	[4]	7	10
85	2	[3]	6	8
86	2	[3]	6	8
87	2	[3]	6	8
88	2	[3]	5	7
89	2	[3]	5	7
90	2	[3]	5	7
91	2	[2]	4	6
92	2	[2]	4	6
93	2	[2]	4	6
94	2	[2]	4	6
95 and over	2	[2]	3	

## Appendix 2 – Analyzing IRS Forms

IRS Form 1040 Heading	Description
Wages, Salaries and Tips	<p>An amount shown under this heading may indicate that the individual:</p> <ul style="list-style-type: none"> <li>• is a salaried employee of a corporation; or</li> <li>• has other sources of income.</li> </ul> <p>This section may also indicate that the spouse is employed, in which case the spouse's income must be subtracted from the Borrower's gross income.</p>
Employee Business Expenses (from Schedule A)	<p>Unreimbursed employee business expenses, as shown on IRS Form 2106, are actual cash expenses that must be deducted from the gross income.</p> <p>Depreciation due to business use of a vehicle may be added to the gross income.</p>
Business Income and Loss (from Schedule C)	<p>Sole proprietorship income calculated on Schedule C is business income.</p> <p>Depreciation, depletion, amortization, and casualty losses may be added back to the gross income.</p>
Business Use of Home	<p>Mortgage interest, Mortgage Insurance Premiums (MIP), real estate taxes, and property insurance deducted for business use of a house may be added back to the gross income.</p>
Rents, Royalties, Partnerships (from Schedule E)	<p>Any income received from rental properties or royalties may be used as income, after adding back any depreciation shown on Schedule E.</p>
Capital Gain and Losses (from Schedule D)	<p>Capital gains or losses generally occur only one time, and should not be considered when determining Effective Income.</p> <p>However, if the individual has a constant turnover of assets resulting in gains or losses, the capital gain or loss must be considered when determining the income. Three years' tax returns are required to evaluate an earnings trend. If the trend:</p> <ul style="list-style-type: none"> <li>• results in a gain, it may be added as Effective Income; or</li> <li>• consistently shows a loss, it must be deducted from the total income.</li> </ul>

## Appendix 2 – Analyzing IRS Forms (continued)

IRS Form 1040 Heading	Description
Interest and Dividend Income (from Schedule B)	<p>This taxable/tax-exempt income may be added back to the adjusted gross income only if it:</p> <ul style="list-style-type: none"><li>• has been received for the past two years; and</li><li>• is expected to continue.</li></ul> <p>If the interest-bearing asset will be liquidated as a source of the cash investment, the Mortgagee must appropriately adjust the amount.</p>
Farm Income or Loss (from Schedule F)	<p>Any depreciation shown on Schedule F may be added back to the gross income.</p>
IRA Distributions, Pensions, Annuities, and Social Security Benefits	<p>The non-taxable portion of these items may be added back to the adjusted gross income, if the income is expected to continue for the first three years of the Mortgage.</p>
Adjustments to Income	<p>Adjustments to income may be added back to the adjusted gross income if they are:</p> <ul style="list-style-type: none"><li>• IRA and Keogh retirement deductions; or</li><li>• penalties on early withdrawal of savings health insurance deductions, and Alimony payments.</li></ul>

### Analyzing IRS Form 1120, *U.S. Corporation Income Tax Return*

A Corporation refers to a state-chartered business owned by its stockholders.

To determine the Borrower's income, the adjusted business income must be multiplied by the Borrower's percentage of ownership in the business.

Corporate compensation to the officers, in proportion to the percentage of ownership, is shown on the corporate tax return (IRS Form 1120), and individual tax returns. If the Borrower's percentage of ownership does not appear on the tax returns, the Mortgagee must obtain the information from the corporations' accountant, along with evidence that the Borrower has the right to any compensation.

The table below describes the items found on IRS Form 1120 for which an adjustment must be made in order to determine adjusted business income.

## Appendix 2 – Analyzing IRS Forms (continued)

Adjustment Item	Description of Adjustment
Depreciation and Depletion	Add the corporation's depreciation and depletion back to the after-tax income.
Fiscal Year vs. Calendar Year	If the corporation operates on a fiscal year that is different from the calendar year, an adjustment must be made to relate corporate income to the individual tax return.
Cash Withdrawals	The Borrower's withdrawal of cash from the corporation may have a severe negative impact on the corporation's ability to continue operating.

### **Analyzing IRS Form 1120S, *U.S. Income Tax Return for an S Corporation***

An "S" Corporation refers to a small start-up business, with gains and losses passed to stockholders in proportion to each stockholder's percentage of business ownership.

Income for owners of "S" corporations comes from W-2 wages, and is taxed at the individual rate. The IRS Form 1120S, Compensation of Officers line item is transferred to the Borrower's individual IRS Form 1040.

Depreciation and depletion may be added back to income in proportion to the Borrower's percentage of ownership in the corporation.

The Borrower's income must be reduced proportionately by the total obligations payable by the corporation in less than one year.

### **Analyzing IRS Form 1065, *U.S. Return of Partnership Income***

A Partnership refers to when two or more individuals form a business, and share in profits, losses, and responsibility for running the company. Each partner pays taxes on their proportionate share of the partnership's net income.

Both general and limited partnerships report income on IRS Form 1065, and the partners' share of income is carried over to Schedule E of IRS Form 1040.

Both depreciation and depletion may be added back to the income in proportion to the Borrower's share of the income.

The Borrower's income must be reduced proportionately by the total obligation payable by the partnership in less than one year.