Creating a Picture of Your Income

What do restaurant servers, used car salespeople and CEOs have in common? They all might find it challenging to document their income when it comes time to apply for a mortgage.

A salaried worker's paycheck provides stability that mortgage companies love. Bonuses that ebb and flow with sales or performance — or more troublesome, the general state of the economy — make banks nervous. And what about your annual bonus that varies from year to year?

The housing crisis that began in 2008 came about in no small part because of mortgages for which buyers were able to state their own income, with no independent verification. These "stated income" loans are no more, and it's easy to see why lenders are taking a much closer look at each applicant's bottom line.

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If your income comes in pieces, it may be more difficult to qualify for a mortgage.

Fannie Mae's own policies leave no question about the matter: "Fannie Mae's underwriting guidelines emphasize the continuity of a borrower's stable income. The stable and reliable flow of income is a key consideration in mortgage loan underwriting. … To demonstrate the likelihood that a consistent level of income will continue to be received for borrowers with less predictable sources of income, the lender must obtain information about prior earnings. Examples of less predictable income sources include commissions, bonuses, substantial amounts of overtime pay, or employment that is subject to time limits, such as contract employees or tradesmen."

All this uncertainty doesn't mean you can't qualify for a mortgage, but it does mean more hoops to jump through. If you earn salary and commission and your salary income is enough to qualify you for the mortgage, you can breathe a sigh of relief.

THE TWO-YEAR STANDARD

A key measure that is common in the mortgage industry is a borrower's income over the most recent two years. That's the time period it seems that the Department of Housing and Urban Development considers sufficient to establish a worker's income and provide some assurance that it will continue at that level.

The ideal situation for a worker whose compensation varies is an income that rises over time. While an applicant whose compensation is trending upward will see his last two years' income averaged over the past 24 months (even if a large portion of it comes but once a year), income that's sloping downward can create problems. In this instance, the underwriter may be required to use the more recent, lower amount of income to determine how much home a buyer can afford.

Knowing this before you go home shopping can help temper your expectations, or allow you to time your home purchase to maximize your buying power.

Any major fluctuations over the previous two years can be troublesome. "Commission income showing a decrease from one year to the next requires significant compensating factors before a borrower can be approved for the loan," according to HUD standards. "A borrower whose commission income was received for more than one year but less than two years may be considered favorably if the underwriter can document the likelihood that the income will continue, and soundly rationalize accepting the commission income."

In addition, job changes can be tricky for workers who earn commission, as banks may not assume that you will continue to earn the same amount going forward.

Tipped workers will have an easier time of proving their earnings, since the IRS requires employers to track even cash tips for tax purposes.

THE PAPER TRAIL

In any event, workers whose incomes vary from paycheck to paycheck will be required to show proof of all income for at least the last two years. Provide pay stubs, W-2s or 1099 forms and tax returns, (IRS Form 4137 for tips). Self-employed applicants should provide profit and loss statements.

REAL ESTATE 101

Staying on Track

Qualifying for a mortgage may show that you've demonstrated some financial responsibility, but owning your first home can bring temptation to spend on new furniture, remodeling and other unnecessary items. Investopedia offers a list of 7 Smart Steps Every New Homeowner Should Take. Read the list at **http://bit.ly/1c3a83a**.

Creating a Picture of Your Income

By ANNA CHANG-YEN | Green Shoot Media

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HOMEWISE GLOSSARY

Mortgage commitment: an agreement between lender and borrower detailing the terms of a mortgage loan such as interest rate, loan type, term, and amount.

Mortgage disability insurance: an insurance policy you can buy that pays off the balance owed if the insured becomes disabled during the term of the mortgage.

Mortgage life insurance: term life insurance paid by the borrower in which the amount of coverage decreases as the mortgage balance declines. In the event that the borrower dies while the policy is in force, the debt is automatically satisfied by insurance proceeds

SOURCE: Wisconsin Department of Financial Institutions