

Income Calculation Basics

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A Comprehensive Guide by The Housing Assistant



Introduction

Accurate income calculation is a critical step in mortgage lending to determine a borrower's ability to repay. Mortgage operations staff must understand how to review income types, calculate averages, and match figures to documentation.

Types of Income

- Base Salary: Typically stable and averaged over the most recent pay periods.
- Bonus Income: Must be averaged over 1–2 years and must be consistent.
- Overtime Income: Must show a 12–24 month history and be averaged.
- Commission Income: Typically averaged over 2 years.
- Part-Time Income: Must be stable and likely to continue.
- Self-Employment Income: Evaluated using tax returns and P&L statements.

How Underwriters Average Income

- YTD (Year-to-Date) income is compared to prior years.
- Income fluctuations must be explained and documented.
- Declining income trends may disqualify borrowers unless stable explanations exist.
- For bonus, overtime, or commission, calculate a two-year average unless specifically instructed otherwise by guidelines.

Required Documentation for Income Types

Income Type	Required Documentation
Base Salary	Paystubs (30 days), W-2s (2 years).
Bonus/Overtime	Paystubs, W-2s, employer VOE confirmation.
Commission	Paystubs, W-2s, tax returns (if >25% of income).
Part-Time	Paystubs and W-2s; must show 2-year history if needed.
Self-Employment	Tax returns (2 years) + P&L statement if applicable.

Simple Examples

- Base Salary: $\$5,000/\text{month} \times 12 \text{ months} = \$60,000/\text{year}$ gross income.
- Bonus: 2022 = \$6,000, 2023 = \$8,000 → Average = \$7,000/year bonus.
- Commission: \$25,000 commission earned in 2023 divided by 12 months = \$2,083/month.

Best Practices for Income Review

- ✓ Always verify stable and likely-to-continue employment.
- ✓ Document income source properly — don't rely on verbal statements.
- ✓ Watch for large fluctuations and escalate declining trends.
- ✓ Follow specific agency/investor rules (Fannie, Freddie, FHA, VA, USDA).

THA Tip:

- ◆ Income calculation errors are one of the most common causes of loan repurchases. Always double-check your math and documentation!