CHAPTER 10: CREDIT ANALYSIS
7 CFR 3555.151

10.1 INTRODUCTION

To be eligible for a guaranteed loan, an applicant must have a credit history that demonstrates that they are reasonably able and willing to repay the loan and meet obligations in a manner that enables the lender to draw a logical conclusion about the applicant's commitment to the indebtedness. It is the applicant's overall credit management skill (e.g. including repayment patterns, credit utilization, and level of experience using credit), not solely the existence of delinquent credit accounts – that has an effect on the eventual default risk of a mortgage. The lender must analyze the entire credit history for each applicant listed on the mortgage application. The extent of the analysis will vary based on whether the lender uses a traditional method to underwrite the loan manually, or is assisted by the Agency's automated underwriting system.

This chapter discusses the Agency's minimum criteria for assessing an applicant's credit history. A lender may impose more stringent criteria. The lender must obtain several types of third-party verifications to determine whether the applicant's credit history meets the Agency's criteria. The lender must evaluate the credit history for each applicant who will be party to the note. An applicant's credit record does not have to be perfect to be eligible for a guaranteed loan as long as any isolated instance is fully explained and supported with documentation. A few instances of credit problems can be acceptable, if the lender determines that an applicant's overall credit record demonstrates an ability and willingness to repay obligations. This chapter discusses the credit documentation that is part of the loan application package for manually underwritten loans and loans utilizing the Agency's automated underwriting system. Loans that receive an "Accept" underwriting recommendation from the Agency's automated underwriting system eliminates the need for the lender to document the credit qualification decision as loan approval requirements are incorporated into the automated system's evaluation. Loans that receive an underwriting recommendation other than "Accept" may require additional documentation of the lender's decision for loan approval. If any applicant is delinquent on a non-tax Federal debt additional documentation and further evaluation will be required.

10.2 CREDIT ELIGIBLITY REQUIREMENTS

The lender must investigate all major indications of derogatory credit to determine whether the reported information is accurate, and whether there is an acceptable explanation for the problem that may justify an exception. Failure to understand the

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nature of a credit problem could cause an application to be rejected on the basis of inaccurate or incomplete information. Attachment 10-A illustrates the method used to evaluate an applicant's credit history when a loan is manually underwritten by an approved lender and does not qualify for ~~streamlined~~ abbreviated documentation noted ~~later~~ in ~~this~~ Chapter 15 of this Handbook. These indicators must be followed consistently; however, the lender can make exceptions in limited circumstances, as described in Paragraph 10.8. Attachment 10-B illustrates the hierarchy of the credit review.

In addition to analyzing the credit report, an applicant is automatically ineligible for a guaranteed loan if they are presently delinquent on a non-tax Federal debt.

If the applicant(s) has had a previous Agency loan that resulted in a loss to the Government, has been settled, or is subject to settlement, additional documentation may be required of the applicant(s) to determine if the loss incurred was beyond the control of the applicant and if any identifiable reasons for the loss still exist.

The lender must verify that the applicant has no delinquent Federal debt through the Credit Alert Verification Reporting System (CAIVRS). CAIVRS is a Federal government-wide repository of information on those individuals with delinquent or defaulted Federal debt, and those for whom a payment of an insurance claim or guarantee loss claim has occurred. **An applicant with an outstanding judgment obtained by the United States in a Federal court, other than the United States Tax Court, is *not* eligible for a guarantee unless otherwise stated in this Chapter.**

Lenders are responsible for screening all applicants using HUD's Credit Alert Verification Reporting System. When a lender utilizes the Agency's automated underwriting system, the CAIVRS confirmation is automatically retrieved once the application is entered. When a lender does not utilize the Agency's automated underwriting system, the lender must obtain and record in the lender's mortgage file the CAIVRS confirmation number. For manually underwritten loans, the Agency will obtain a CAIVRS confirmation number in GLS through the service available. Each request of the CAIVRS service for the same applicant will record different confirmation numbers.

Lender instructions for accessing CAIVRS are included in Appendix 7. The presence of delinquent non-tax Federal debt cannot be waived by a lender.

10.3 CREDIT REPORT REQUIREMENTS

The credit report the lender uses to assist in the assessment of credit eligibility must come from a recognized credit repository and cannot be provided by a credit reporting agency that is affiliated with the lender in any way. Types of credit reports include:

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- Automated Merged Credit Reports;
- Residential Mortgage Credit Report (RMCR).

A. Automated Merged Credit Reports

An automated merged credit report – also known as a multi-merged credit report (MMCR) or Three-Repository Merged Credit Report (TRMCR) - combines in-file credit reports from multiple repositories into a single report. A joint merged credit report includes all credit repository credit data on two individual applicants who are married to each other.

The report must meet the requirements of Fannie Mae, Freddie Mac, FHA or VA, which include, but are not limited to the following requirements:

- The report should include all information from three different credit repositories, or two repositories, if that is the extent of the data available for the applicant.
- The report must include all credit and legal information reported for the applicant from the three (or two, if applicable) in-file credit reports not considered obsolete under the Fair Credit Reporting Act (FCRA), including information for the last seven years regarding bankruptcies, judgments, law suits, foreclosures, and tax liens.

B. Residential Mortgage Credit Reports

A residential mortgage credit report is a detailed account of the applicant's credit, employment and residency history, as well as public records information.

The report must meet the requirements of Fannie Mae, Freddie Mac, FHA or VA, which include, but are not limited to the following requirements:

- The report must include a certification that it meets the standards for a residential mortgage credit report.
- Include a check with the creditor within 90 days of the credit report for each applicant's account with a balance.
- Verify each applicant's current employment and income, if obtainable. If unable to verify and certify to the applicant's current employment, state a reason for not completing an interview with the applicant's employer.
- Provide a detailed account of the applicant's employment history.

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Any credit report must:

- Not be more than 120 days old when the loan is closed;
- Be accurate and complete;
- Provide an account of the credit, residence history, and public record information for each applicant who is a party to the note;
- Be submitted as an original document, either the original electronic version or the printed report delivered by the credit reporting agency;
- Have no whiteouts, erasures or alterations;
- Indicate the name and address of the consumer reporting agency;
- Show the primary repository from which the particular information was pulled for each account listed; and
- Show the name of the party ordering the report;

Lenders must order an RMCR if any of the following circumstances apply:

- An applicant disputes accounts;
- An applicant claims that collections, judgments, or liens reflected as open on the credit report have been paid and cannot provide separate supporting documentation;
- An applicant claims that a debt shown on the credit report has a different balance and/or payment and cannot provide a statement less than 30 days old; or
- The lender's underwriter determines that it would be prudent to utilize a RMCR rather than a tri-merged report to properly underwrite the loan.

If a credit report indicates other credit inquiries have been made by the applicant in the 90 days prior to the date of the credit report, the lender should determine why the inquiry was made and whether credit was obtained by the applicant.

10.4 CREDIT REPORT VERSIONS

For mortgages assessed through the Agency's automated underwriting system, a decision underwriting score is obtained for each applicant as further explained in

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Paragraph 10.7 of this Chapter. Credit scoring models consider the primary types of credit obtained by the applicant based on the mix of the applicant's various credit accounts. Among other things, scoring models consider the following risk factors when assigning a credit score to an applicant:

- Number and age of accounts
- Payment history (length of payment history and habit of payment)
- Credit utilization (the amount of debt, new credit obtained, type of credit, open credit cards)
- Recent attempts to obtain new credit (inquiries)

In obtaining those scores, the following scoring models are recognized in the Agency's automated underwriting system in the order listed. Any model other than the source noted below will not be recognized by the system.

Scoring Model Source	Description	Scoring Model Code
Experian	Experian/Fair Isaac risk Model v3	15
Experian	New Experian Fair Isaac Model (FICO II)	6
Equifax	Beacon 5.0	13
Equifax	Beacon 96	3
Transunion	FICO Risk Score Classic (04)	14
Transunion	FICO® Risk Score, Classic (98)	9

If lenders are not using the Agency's underwriting system, utilizing credit scores to underwrite manually underwritten mortgages is the preferred method. For manually underwritten loans, lenders should ensure the credit models noted above are utilized in the underwriting decision.

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10.5 ESTABLISHING THE APPLICANT'S CREDIT REPUTATION

At least one applicant whose income or assets are used for qualification must have at least three historical trade line payment references that have existed for at least 12 months to establish a credit reputation and validate the credit score. If not on the credit report, establish a minimum payment history through use of a non-traditional report as explained in Paragraph 10.6 of this Chapter. Non-traditional credit may not be used to enhance poor payment records or low credit scores.

Loans underwritten with the assistance of the Agency's automated underwriting system that receive an "Accept" recommendation are also subject to the credit score validation of this Paragraph. A trade line in a documented dispute with 12 months of history is considered an eligible trade line. The inability to validate credit scores used by GUS will require lenders to downgrade an "Accept" underwriting recommendation to a "Refer" and establish minimum payment history through use of a non-traditional report. .

10.6 OBTAINING NON-TRADITIONAL CREDIT HISTORY

Some applicants may not have an established credit history, but credit verified through alternative sources may indicate a willingness to pay recurring debts. Neither the lack of a credit history nor the applicant's decision to not use traditional credit can be used as a basis for rejection. For these applicants, the lender may develop a Non-Traditional Mortgage Credit Report (NTMCR). A NTMCR may be used as a substitute for an RMCR or MMCR/TRMCR. An NTMCR may not be used to offset derogatory references found in the applicant's RMCR or MMCR/TRMCR; it should not be utilized to enhance the credit history of a applicant with a poor payment record or to manufacture a credit report for a applicant without a verifiable credit history.

The preferred method is all nontraditional credit references be verified by a credit bureau and reported back to the lender as a nontraditional mortgage credit report in the same manner as traditional credit references. If a NTMCR is impractical, or such a service is unavailable, a lender may choose to obtain independent verification of trade references. Three trade references are required when at least one of the trade references includes verification of rental housing payments or mortgage loan payments. If unavailable, at least four trade references must be used to determine if an applicant has a sufficient credit history.

Acceptable forms of documentation for a NTMCR include:

- Cancelled checks;
- Third-party verifications; or

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- Non-traditional credit report for the following non-traditional credit sources that include the creditor's name, date the account was opened, account balance, monthly payment due, and payment history reported in 0x30, 0x60, 0x90 format. Subjective statements such as "satisfactory" or "acceptable" are not an acceptable format for repayment history confirmation. Rural Development will accept reports by providers who develop bill payment histories.

Acceptable trade-line sources include an open and recent 12-month payment record of the following:

- Rent payments;
- Utility payment records (if utilities were not included in any rent payments) such as gas, electricity, water, land-line home telephone service or cable TV;
- Insurance payments (excluding those paid through payroll deductions) such as medical, automobile, life and household, or renter's insurance;
- Payments to child care providers – made to a business providing such a service;
- School tuition;
- Payments to local stores (department, furniture, appliance and specialty stores);
- Payments for the uninsured portions of any medical bills;
- Internet/cell phone services;
- Automobile leases;
- A personal loan from an individual (other than a family member) with repayment terms in writing and supported by cancelled checks or money order receipts to document repayment;
- A documented 12-month history of saving by regular deposits (at least quarterly/non-payroll deducted/no NSF checks reflected), resulting in a reserve account equal to three months of proposed mortgage payments (PITI) as a cash reserve post-closing; or
- Any other reference which gives insight into the applicant's willingness to make periodic payments on a regular basis for credit obligations.

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Payments made to relatives for credit sources are ineligible as a non-traditional trade reference.

Lenders should exercise caution when evaluating applicants with non-traditional credit histories. Generally these applicants may be considered a higher risk than applicants who have credit scores meeting the criteria in this Chapter. Applicants may only have one 30 day delinquency on any non-traditional trade line within the last 12 months. 60 and 90 day delinquencies, as well as reports of disconnection notices or collection accounts/court records (other than medical) filed in the past 12 months are unacceptable. Ratios for housing expense and debt-to-income expense should be minimal.

10.7 CREDIT SCORES

A credit score is a numeric representation of financial behavior, based on information found in a credit report. Credit scores are primarily based on five factors:

- Payment history
- Amounts owed
- Length of credit history
- New Credit, and,
- Types of credit used.

A lower score represents a higher credit risk, while a higher score indicates a lower credit risk.

Credit scores are an effective tool in evaluating an applicant's credit reputation. As a quantitative measurement of risk, credit scores enable an underwriter to process mortgage applications more accurately and quickly, and with a greater degree of confidence. The use of credit scores speed up the approval process for an applicant who represents a low credit risk and allows the underwriter more time to analyze the creditworthiness of a higher-risk applicant. These scores objectively evaluate all the information in the applicant's repository credit file at the time the credit score was created. A strong correlation between mortgage performance and credit scores has been identified. The use of credit scores in underwriting can reduce the risk of originating mortgages with unacceptable credit risk.

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A credit score in its self does not indicate that the applicant's credit reputation is acceptable. Even when the credit score exceeds the minimum requirement, the lender must determine that each applicant, individually, and all applicants collectively, have an acceptable credit reputation.

A. Acceptable Credit Scores

Applicants with credit scores of 640 or greater meet the minimum credit reputation provided the following indicators of unacceptable credit are not present in the applicant's credit file:

Indicators of unacceptable credit:

- Foreclosure within 3 years:
  - Including pre-foreclosure activity, such as a pre-foreclosure sale or short sale in the previous 3 years;
- Bankruptcy within 3 years:
  - Chapter 7 bankruptcy discharged in the previous 3 years;
  - Chapter 13 bankruptcy that has yet to complete repayment or has completed payment in the most recent 12 months;
- Late mortgage payments if any mortgage trade line during the most recent 12 months shows 1 or more late payments of greater than 30 days.
- Late rent payments paid 30 or more days late within the last 12 months.

Even when the credit score exceeds 640, the lender must determine that each applicant individually, and all applicants collectively, have an acceptable credit reputation.

When the loan is manually underwritten, the primary wage earner should be treated as the applicant and all other applicants are considered co-applicants. Credit trade-lines that list the applicant as an "authorized user" cannot be considered in the underwriting decision unless another applicant in the mortgage transaction is the owner of the trade-line, or the owners of the trade-line is the spouse of an applicant, or the applicant can provide documented evidence that they have made the payments on the authorized user account for 12 months preceding application.

If the applicant's credit report has three scores, the middle score should be used as the representative score. If the applicant has two scores, the lower of the two should be used

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as the representative score. If the applicant has a repeating score, that score will be utilized. If the applicant has one score, a NTMCR must be developed for manually underwritten loans. The Agency's automated underwriting system will determine the applicable score when developing an underwriting recommendation and may utilize a single score. Each applicant must be evaluated separately.

All instances of adverse credit must be addressed by the lender's underwriter and documentation surrounding this review must be retained in the lender's permanent loan file.

For manually underwritten loans, a credit waiver with supportive documentation validating the circumstances leading to the adverse credit is required for all loans receiving a credit score of 581 or above. Loans with credit scores of 580 or below should not be approved.~~.~~

If a lender omits an adverse trade line when utilizing GUS and receives an "Accept" the applicant explanation letters and supportive documentation of adverse trade lines will be retained by the lender. The "Notes" section of the "Asset and Liabilities" page will reflect the lenders basis for omitting the trade line.

The lender remains responsible for evaluating and confirming the representation of accurate data in GUS. Improper omission of trade lines could misrepresent the strength of the recommended underwriting decision and could adversely affect the future payment of the guarantee should a loss occur.

B. Underwriting with Credit Scores

When manually underwriting with credit scores, the lender must not use offsets for weaknesses in the applicant's credit reputation as they have already been considered in creating the credit score. Such offset factors include:

- The age of derogatory information;
- The number or types of accounts paid as agreed versus delinquent accounts;
- Recent pay-down or pay-off of account balances by the applicant; and
- Any combination of the above factors.

The lender's underwriting decision to approve a mortgage must be based on an overall evaluation of the risks documented in the mortgage file. Underwriters must consider the entire credit profile of each applicant and not approve a loan based upon a single component. The lender may consider the strength of some components against the

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weakness of one component to arrive at a conclusion. The lender must document the evaluation in the lender's permanent mortgage file. Whenever there is evidence of layered risk, more conservative underwriting standards must be utilized.

A score factor accompanies each applicant's credit score. The codes are useful in understanding which factors are most responsible for arriving at the applicant's credit score. In cases where a applicant is determined to be too great a risk for approval at the present time, the lender can use the score factor to assist the applicant with the appropriate path to follow to achieve homeownership in the future.

10.8 CREDIT EXCEPTIONS

Credit history problems do not always reflect an unwillingness to meet financial obligations. If the lender believes that the applicant is creditworthy, the lender should document on the underwriter's analysis the reasons that an exception is justified. Exceptions should be made only in the following types of situations.

- **Temporary situation.** The circumstances that caused the credit problems were temporary in nature, beyond the applicant's control, and the circumstances have been removed and resolved for the 12 months prior to application. Examples include a temporary loss of job, delay or reduction in benefits, illness, or dispute over payment for defective goods or services.

- **Reduced housing expenses.** The loan will significantly reduce the applicant's housing expenses, which will result in improved debt repayment ability. A significant reduction in housing expenses would be 50 percent or more.

It remains the lender's responsibility to underwrite the mortgage application request. The individual loan file should contain clear evidence that the lender evaluated the credit information for each applicant and arrived at a conclusion that the applicant's credit history (even if brief or non-traditional) demonstrates an ability to handle financial obligations successfully. No Agency-granted waiver or concurrence is required for credit exceptions. Applicants must provide supporting documentation that meets these requirements to ensure the lender's permanent loan file is well documented and supported. The lender must retain the underwriter's documentation as part of the case file that supports the decision to waive derogatory credit. Documentation will also be noted on the underwriting transmittal summary to include the supporting documentation provided by the applicant(s) to explain the reason(s) for derogatory information (e.g. undisclosed debts, judgments, bankruptcies, etc.) for all loans that do not qualify for ~~streamlined~~ abbreviated documentation noted ~~earlier~~ in ~~this c~~Chapter 15 of this Handbook. The lender must determine if the explanation and supportive documentation

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makes sense and whether it is consistent with other information in the credit report. The applicant(s) documentation should confirm the nature of the event that led to the derogatory credit deficiencies and illustrate that they had no reasonable options other than to default on their financial obligations. The event, the severity of the resulting hardship, and the extent of the applicant(s) efforts to resolve the situation should be taken into consideration when making an underwriting decision. Documentation provided by the applicant(s) may open new questions. The lender's underwriter must use careful underwriting judgment in evaluating loan requests involving derogatory credit.

The lender is not authorized to make an exception in the case of an applicant with a delinquency on a Federal debt, or with an outstanding judgment obtained by the United States in a Federal court, other than the United States Tax Court. Evidence of payment arrangements is acceptable for IRS Federal tax judgments. The approved lender's underwriter must determine if the elapsed portion of the repayment period is of appropriate duration. An applicant(s) who has been delinquent during the repayment period is ineligible for a guaranteed loan.

10.9 COLLECTION ACCOUNTS

Collection accounts are factored into the credit score. Collection accounts will be considered in the analysis of credit and capacity.

For manually underwritten loans, the lender's underwriter should document any mitigating circumstances to the adverse credit when evaluating the credit history of the applicant(s). For loans underwritten with the assistance of GUS, lenders remain responsible for considering the existence of unpaid collections and the history of the collection accounts in the credit analysis and loan making decision.

Paying an outstanding collection account is not justification, in itself, that would establish an applicant's willingness to meet obligations in an acceptable manner. Payment of the collection account may cause the depletion of cash resources that may otherwise be available as reserves or for closing costs. The lender is responsible for determining which collection accounts, if any, should be paid in full by the applicant prior to or at loan closing. The repayment in full of unpaid collections is not a condition of mortgage approval. Whether a collection account represents a greater risk is entirely the lender's decision, regardless of the credit score. This decision will be based upon several factors including the credit profile of the applicant(s), the amount of meaningful financial reserves available, the unpaid balance of the collection accounts, and whether they pose a threat to the first mortgage lien and are likely to affect the applicant's equity or ability to repay the requested loan. Lenders must conclude the applicant did not disregard his or her financial obligations. Outside factors, such as disputes, illness, loss of job may have contributed. Lenders will evaluate all outstanding collection accounts. Lender

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underwriters should perform additional analysis when making credit determinations if they encounter collection accounts that have:

- A record of irregular payments; or
- No satisfactory arrangements for repayment; or
- Payment in full within the last 6 months just prior to application, unless the applicant had been previously making regular payments.

For a manually underwritten loan, the lender must document reasons for approving a loan request when collection accounts are present and remain unpaid. The preferred method to document a lender' decision to leave collections unpaid is the underwriting analysis. For each outstanding collection account, the applicant must provide a letter of explanation together with documentation supporting the applicant's justification. The supporting documentation and explanation must be consistent with other credit information in the file.

For loans underwritten with GUS, a letter of explanation or documentation supporting the presence of unpaid collections is not required when the underwriting recommendation is an "Accept." The lender will document reasons for approving a loan request when collection accounts remain unpaid. The preferred method to record the lenders analysis/reasons for approving the loan is to document their justification on the credit liability line under "notes" on the "Assets and Liabilities" page beside each individual collection.

Unpaid open collections could affect the future ability of an applicant to repay a mortgage when creditors pursue collection. In an effort to minimize future risk of open collections left unpaid, the lender will consider the following during the capacity analysis of the loan request, regardless of the method utilized to underwrite:

1) Determine if the total outstanding balance of all collections accounts of all applicants is equal to or greater than $2,000. Unless excluded by state law, collection accounts of a non-purchasing spouse in a community property state are included in the cumulative balance of all collections.
2) Remove all medical collections and charge off accounts from the total balance. Medical collections and charge off accounts must be clearly identifiable on the credit report.
3) If the remaining outstanding balance of collection accounts are equal to or greater than $2,000, any of the following actions will apply:
    a. Payment in full of all collection accounts at or prior to closing.
    b. Payment arrangements are made with each creditor for each collection account remaining outstanding. A letter from the creditor or evidence on the credit report is required to validate the payment arrangements. The

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agreed upon monthly payment for each outstanding collection account will be included in the borrower's debt-to-income ratio.

c. In the absence of a payment arrangement, the lender will utilize in the debt-to-income ratio a calculated monthly payment. For each collection utilize 5% of the outstanding balance to represent the monthly payment.

10.10 JUDGMENTS

The presence of court-ordered judgments must be considered in the credit analysis. Unpaid judgments may represent an applicant's disregard for credit obligations. Lenders must document reasons for approving a mortgage when the applicant has judgments. Usually judgments are paid in full prior to loan eligibility. An exception to payment in full of outstanding judgments can be made when the applicant(s) have a payment arrangement with the creditor and have made regular and timely payments for the three months prior to loan application. Prepaying scheduled payments as a means of meeting minimum requirements is unacceptable. Lenders will obtain a copy of the payment agreement and validate payments have been made in accordance with the payment agreement. The payment agreement will be included in the debt-to-income ratio.

Unless precluded by state law, judgments of a non-purchasing spouse in a community property state will be paid in full or meet the exception guidance provided in this Paragraph.

10.11 DISPUTED ACCOUNTS

Disputed accounts on an applicant's credit report are not considered in the credit score. For manually underwritten loans, all disputed accounts must have a letter of explanation and documentation supporting the basis of the dispute. The lender is responsible for analyzing the documentation presented and confirming that the explanation and supporting documentation are consistent with the credit record during the underwriting analysis.

Loans underwritten with the assistance of GUS that receive an underwriting recommendation of "Accept" will be downgraded to a manual "Refer" unless the following conditions are met on the credit report:

1) The disputed trade line has a zero dollar balance.

2) The disputed trade line is marked "paid in full" or "resolved."

3) The disputed trade line has a balance owed of less than $500 and is more than 24 months old.

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Loans downgraded for failure to meet any of these conditions are subject to a manual review and require the submission of the complete underwriting case file.

10.12 AUTHORIZED USER TRADE LINES

The lender must review credit report trade lines in which the applicant has been designated as an authorized user in order to ensure that any open trade lines are an accurate reflection of the applicant's credit history. Closed authorized trade lines require no consideration.

For loans underwritten with the assistance of GUS that receive an underwriting recommendation of "Accept" and are supported by credit reports that designate the applicant an authorized user of trade lines, the lender will obtain evidence of one the following:

1) The trade line(s) in question is owned by another applicant on the mortgage loan application.

2) The owner of the trade line is the spouse of an applicant.

3) The applicant has made payments on the account for the previous 12 months prior to application.

In the event one of the conditions cannot be met, an underwriting recommendation of "Accept" must be downgraded to a "Refer" and the file must be manually underwritten.

10.13 RENT HISTORY

Some first time homebuyers do not have a verifiable housing or rent payment history. In such cases, a rent history is not required. If the applicant's and co-applicant's credit score is under 680 and the applicant(s)/co-applicant(s) has a rent payment history, the lender should obtain a rent payment reference either as part of credit report, or directly from the landlord, or through cancelled checks covering the most recent 12 months prior to the loan application. When a private individual is the applicant's present landlord, 12 months' worth of cancelled checks indicating a satisfactory rent payment history is preferred. Written verifications by independent management companies and private landowners may be accepted in lieu of canceled checks or money order receipts. If the applicant does not have a full 12 month history, verify any previous payment made in the last 12 months. Written verification must include creditor name, date of the rental agreement or when the contract began and the monthly payment due. Payment history must be reported in 0x30, 0x60, 0x90 day format. Statements such as "satisfactory" or "acceptable" are not valid.

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It remains the lender's responsibility to confirm the applicant's history of payment towards housing expense is acceptable. One rent or mortgage payment paid 30 or more days late within the last 12 months is an indicator of unacceptable credit unless the new mortgage loan request will reduce shelter costs significantly and contribute to improved repayment ability. Lenders may consider extenuating circumstances surrounding late rent payments under Paragraph 10.8 of this Chapter.

Lender's should carefully underwrite loan applicants who live rent free or do not have a recent 12-month history of paying rent.

Applicants with credit scores of 680 and above are not subject to verification of rent or housing history.

Loans underwritten with GUS that receive an "Accept" underwriting recommendation are not subject to verification of rent or housing history.

10.14 PAYMENT SHOCK

The term "payment shock" signifies the increase in housing expenses experienced by an applicant. Payment shock is defined as a percentage under the following formula:

(New Principal Interest Taxes and Insurance (PITI) ÷ Previous Housing Expense) – 1

EXAMPL	a. The applicant's new PITI is $187.00 and their former rent was $100.00. b. 187.00 ÷ 100.00 = 1.87; 1.87 – 1 = .87; .87 = 87 percent c. The payment shock in this example is 87 percent.
	a. The applicant's new PITI is $345.00 and their former rent was $150.00. b. 345.00 ÷ 150.00 = 2.30; 2.30 – 1 = 1.30; 1.30 = 130 percent c. The payment shock in this example is 130 percent.

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E **S**	a. The applicant's new PITI is $2,000.00 and their former rent $1,000.00 b. 2,000.00 ÷ 1,000.00 = 2.00; 2.00 **-** 1 = 1.00; 1.00 = 100 percent c. The payment shock in this example is 100 percent.

In cases where the applicant did not have a housing expenses prior to purchasing a home, such as if the applicant was living with relatives, payment shock cannot be measured as a percentage.

Payment shock by itself (without the presence of other risks) is not an additional risk layer. Payment shock is a risk layer for underwriters to consider when the PITI ratio exceeds 29% and the proposed mortgage payment is 100% or greater than current housing expense. Payment shock is not a risk layer and requires no further supportive documentation if the PITI ratio is 29% or less.

In cases where payment shock is 100 percent or higher and qualifying PITI ratios are exceeded as noted above, as well as in cases where the applicant did not have a housing expense prior to purchasing a home, no additional risk layering (such as adverse credit waivers, debt ratio waivers, or temporary buydown) should be allowed without strong compensating factors. Acceptable compensating factors include, but are not limited to, the following examples:

- The applicant(s) has an ability to accumulate savings or cash reserves;
- The applicant(s) has a demonstrated conservative attitude toward using credit;
- The applicant(s) has potential for increased earnings, as indicated by job training or education in the applicants profession;
- The applicant(s) has a representative credit score of 680 or higher.

10.15 NON-PURCHASING SPOUSE CREDIT HISTORY

The non-purchasing spouse's credit history is not considered a reason to deny a loan application. In community property states, the non-purchasing spouse's obligations must be considered in the debt-to-income ratio unless excluded by State law. Lenders must comply with applicable lending laws in community property states. Lenders must obtain a credit report that meets the requirements of this Chapter for the non-purchasing spouse in order to determine the debts that must be counted in the debt-to-income ratio.

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The Agency's automated underwriting system will retrieve credit reports for applicants only. Therefore, lenders must obtain an acceptable credit report outside of the system. Liabilities for a non-purchasing spouse should be entered on the "Asset and Liabilities" page in the liability section. When recording the debt, lenders should reference the liability as a non-purchasing spouse debt in the "Notes" data field of the credit liability line. Lenders will retain a copy of the non-purchasing spouse credit report in their permanent mortgage file. Submit a copy to Rural Development when requesting a commitment for Loan Note Guarantee.

Community property states include: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Puerto Rico allows property to be owned as community property as do several Indian jurisdictions. Alaska is an opt-in community property state. Property is separate unless both parties agree to make it community property through a community property agreement or a community property trust.

10.16 PRUDENT UNDERWRITING

It is the Agency's expectation that lenders will act responsibly when originating and underwriting SFHGLP loans. Rural Development does not re-underwrite the mortgage loan application request. This remains the approved lender's responsibility. When lending to low- and moderate-income applicants, lenders are expected to use professional judgment and rely upon prudent underwriting practices to determine the likelihood of successful homeownership. The use of the Agency's automated underwriting system does not replace the judgment of experienced underwriters. The automated underwriting system is a tool that helps evaluate the credit risk of the loan request. The lender must evaluate and confirm the representation of accurate data. The Agency expects lenders to employ prudent underwriting judgment in assessing whether a loan should be approved and submitted to the Agency.

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ATTACHMENT 10-A

CREDIT UNDEWRITING

This attachment illustrates the approach to reviewing credit history when a loan is **manually underwritten** by an approved lender.

Credit score over 680: Perform a basic level of underwriting to confirm the applicant has an acceptable credit reputation. Perform additional analysis if the applicant's credit history has indicators of unacceptable credit as noted in Paragraph 10.7 of this Chapter.

Credit score 679 to 640: Perform a comprehensive level of underwriting. Underwrite all aspects of the applicant's credit history to establish the applicant has an acceptable credit reputation. Credit scores in this range indicate the applicant's reputation is uncertain and will require a thorough analysis by the underwriter of the credit to draw a logical conclusion about the applicant's commitment to making payments on the new mortgage obligation. The applicant's credit history should demonstrate his or her past willingness and ability to meet credit obligations.

Credit score less than 640: Perform a cautious level of underwriting. Perform a detailed review of all aspects of the applicant's credit history to establish the applicant's willingness to repay and ability to manage obligations as agreed. Unless there are extenuating circumstances documented in accordance with this Chapter, a credit score in this range is generally viewed as a strong indication that the applicant does not have an acceptable credit reputation.

Little or no credit history: The lack of credit history on the credit report may be mitigated if the applicant can document a willingness to pay recurring debts through other acceptable means such as third party verifications or cancelled checks. Due to impartiality issues, third party verifications from relatives of household members are not permissible. Lenders can develop a Non-Traditional Credit Report for applicants who do not have a credit score in accordance with Paragraph 10.6 of this Chapter.

An applicant with an outstanding judgment obtained by the United States in a Federal court, other than the United States Tax Court, is *not* eligible for a guarantee unless otherwise stated in this Chapter.

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ATTACHMENT 10-B

THE CREDIT REVIEW

This attachment illustrates the order and importance of a credit review when evaluating how payments by an applicant ~~are~~ will be made. Applicants are expected to have acceptable credit, a stable income and no recent unsupported debt problems. To meet these requirements, applicants must prove they are creditworthy and unlikely to default on the loan requested. ~~It~~ This attachment is intended to assist lenders in their analysis of the credit file when combining the presence of the following items with the applicant's credit score in the underwriting decision. Exceptions are noted for files that are underwritten with the assistance of the Agency's automated underwriting system.

Previous Rental or Mortgage Payment History

- The applicant's housing obligation payment history holds significant importance when evaluating credit. It is an indicator of the applicant's ability to pay the mortgage payment in the future. Applicants who make rental or mortgage payments equal to or above the anticipated mortgage payment generally demonstrates the applicant can pay the future mortgage loan payment. Other eligibility requirements also apply. Generally, unless there is major derogatory credit noted in the credit file, an applicant is considered to have an acceptable credit history if she/she does not have late housing payments.

  - Applicants who live rent-free prior to purchasing a home may require the lender to cautiously approach a loan decision. Sometimes applicants live rent free for supported reasons. For example, applicants may still live at home with parents while in college, may have lived in military provided housing, or living with someone having a lease and wasn't on the lease. Living rent free and proposing to exceed the repayment ratios outlined in Chapter 11 of this handbook may represent a high risk when unsupported. Lenders must approach this type of applicant prudently if approving an application.

  - Automated underwriting files that receive an "Accept" underwriting recommendation are not subject to additional rental or mortgage payment history documentation.

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Recent and/or Undisclosed Debts and Inquiries

- Lenders must determine the purpose of any recent debts as the indebtedness may have been incurred to obtain funds to close the loan. Any new debt and payment must be included in the underwriting analysis.

- An applicant must provide a satisfactory explanation for any significant debt noted on the credit report, but not included on the loan application.

  - Confirm and include any monthly payment amount for debts not considered in the automated underwriting system recommendation. Resubmit the loan for an updated underwriting recommendation. Lenders must apply due diligence when reviewing the documentation in the loan file to determine if there is any

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potentially derogatory or contradictory information that is not part of the data submitted to GUS or if there is erroneous information in the data submitted to GUS. If the lender is aware of any contradictory, derogatory or erroneous information, lenders are obligated to take action. For example if the lender is aware of debts, late payments or derogatory information that has not been made available to the data submitted to GUS, or there is a Federal judgment, a risk analysis decision of "Accept" must be manually downgraded and the file manually underwritten.

Collections and Judgments

- Collections and judgments indicate an applicant's regard for credit obligations, and must be considered in the creditworthiness analysis.

- The lender must document reasons for approving a mortgage when the applicant has collection accounts or judgments. The applicant must explain, in writing and/or provide supportive documentation, for all collections and judgments as outlined in Paragraph 10.9 and 10.10 of this Chapter.

Paying off Collections and Judgments

- Collection accounts are not required to be paid off as a condition of a guarantee. Paragraph 10.9 of this Chapter outlines additional actions required when the outstanding balance of all collections collectively exceeds $2,000. However, court-ordered judgments MUST be paid off before the mortgage loan is eligible for a guarantee unless the applicant provides documentation indicating that regular payments have been made on time in accordance to a documented agreement with a creditor. Paragraph 10.10 outlines additional actions and requirements of a documented payment agreement.

  - If a loan is underwritten with the assistance of the Agency's automated underwriting system, then regardless of the underwriting recommendation, the findings report will require the lender to obtain evidence of payoff for any outstanding judgments shown on the credit report. Lenders are reminded the "Declaration" questions within the Agency automated underwriting system or when completed manually should accurately reflect a response representative of the applicant's credit status.

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Previous Mortgage Foreclosure

- An applicant is generally not eligible for a new guarantee, if during the prior three years the applicant's previous real property was foreclosed on or they have given a deed-in-lieu of foreclosure.

- The lender may grant an exception in accordance with Paragraph 10.8 of this Chapter.

- The inability to sell the property due to a job transfer or relocation to another area does not qualify as an extenuating circumstance.

- Divorce is not considered an extenuating circumstance. However, an applicant whose loan was current at the time of a divorce in which the ex-spouse received the property and the loan was later foreclosed may qualify as an exception.

Chapter 7 Bankruptcy

- A Chapter 7 bankruptcy (liquidation) does not disqualify an applicant from obtaining a mortgage loan if at least three years have elapsed since the date of the discharge of the bankruptcy. During this time, the applicant must have re-established good credit or chosen not to incur new credit obligations.

- An elapsed period of less than 2 years may be acceptable for a loan guarantee if the applicant can show the bankruptcy was caused by extenuating circumstances beyond their control and has since exhibited a documented ability to manage their financial affairs in a responsible manner for a reasonable period of time following discharge.

- The lender must document the applicant's current situation indicates the events that led to the bankruptcy are not likely to recur.

- When a Chapter 7 bankruptcy absolved the mortgage debt for the applicant, any foreclosure or remaining foreclosure pending is an action against the property, not the applicant. The foreclosure action is not considered as adverse credit in the applicant's evaluation. A loan underwritten with the assistance of GUS will not be required to be manually down-graded when the bankruptcy discharge included the mortgage debt.

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- If an applicant has a real estate mortgage discharged in a Chapter 7 bankruptcy, however a foreclosure action is not concluded, the applicant may remain in ownership of the property. In this example, title must be transferred to the lender of the pending foreclosure in order to remove the applicant from ownership and responsibility of real estate taxes and homeownership dues of the property. If title is not transferred, the applicant will be subject to Chapter 8 of this Handbook for retention of a dwelling and any individual responsibility (real estate taxes, homeownership dues, insurance, etc.) in long the term debt calculation.

Chapter 13 Bankruptcy

- A Chapter 13 bankruptcy plan in progress does not disqualify an applicant from obtaining a mortgage loan, provided the lender documents 12 months of the debt restructuring plan has elapsed, the applicant's payment performance has been satisfactory, and all required payments were made on time. The applicant must receive written permission from the bankruptcy court/trustee to enter into a mortgage transaction. A credit waiver by the lender will be required for a manually underwritten loan.

- A completed Chapter 13 bankruptcy plan will not require a credit waiver provided the applicants have demonstrated a willingness to meet obligations when due for the 12 months prior to the date of loan application.

Consumer Credit Counseling Plans

- An applicant who has experienced credit or financial management problems in the past may have elected to participate in consumer counseling sessions to learn how to correct or avoid such problems in the future. Participation in a consumer credit counseling program does not disqualify a applicant from obtaining a mortgage loan, provided the lender documents that one year of the pay-out period has elapsed under the plan, the applicant's payment performance has been satisfactory and all required payments have been made on time. The lender must evaluate the applicant's credit in accordance with Paragraph 10.8 of this Chapter. Some creditors may still report the applicant as delinquent, even though they have agreed to accept a lesser payment. This must be considered in the analysis of the applicant's overall credit. Written permission from the counseling agency to enter into the mortgage transaction and counselor recommendation of the applicant as a good credit risk is required.

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- The Agency's automated underwriting system does not trigger a requirement for additional documentation since the credit scores already reflect the degradation in credit history. No further explanation or other documentation is required when a lender utilized the Agency's automated underwriting system and receives an "Accept" underwriting recommendation.

Evaluating Credit Involving Short Sales

- A short sale is considered a pre-foreclosure activity or event.

- An applicant is ineligible for a mortgage loan if they pursued a short sale agreement on their principal residence to take advantage of declining market conditions and purchases at a reduced price a similar or superior property within a reasonable commuting distance.

- If an applicant was current at the time of short sale, they may be eligible for a new mortgage loan. The prior mortgage payment history must reflect all mortgage payments due were made on time for the 12 month period preceding the short sale and all installment debt payments for the same period were also made within the month due.

- An applicant in default on their mortgage at the time of the short sale (or pre-foreclosure sale) is not eligible for a new mortgage loan for three years from the date of pre-foreclosure sale.

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