

2-3: ANALYZING THE BORROWER'S CREDIT (10/03)

Past credit performance serves as the most useful guide in determining a borrower's attitude toward credit obligations and predicting a borrower's future actions. A borrower who has made payments on previous and current obligations in a timely manner represents reduced risk. Conversely, if the credit history, despite adequate income to support obligations, reflects continuous slow payments, judgments, and delinquent accounts, strong compensating factors will be necessary to approve the loan.

When analyzing a borrower's credit history, examine the overall pattern of credit behavior, rather than isolated occurrences of unsatisfactory or slow payments. A period of financial difficulty in the past does not necessarily make the risk unacceptable if the borrower has maintained a good payment record for a considerable time period since the difficulty. When delinquent accounts are revealed, the lender must document their analysis as to whether the late payments were based on a disregard for financial obligations, an inability to manage debt, or factors beyond the control of the borrower, including delayed mail delivery or disputes with creditors.

While *minor* derogatory information occurring two or more years in the past does not require explanation, *major* indications of derogatory credit -- including judgments, collections, and any other recent credit problems -- require sufficient written explanation from the borrower. The borrower's explanation must make sense and be consistent with other credit information in the file.

Neither the lack of credit history nor the borrower's decision not to use credit may be used as a basis for rejecting the loan application. We also recognize that some prospective borrowers may not have an established credit history. For those borrowers, and for those who do not use traditional credit, the lender must develop a credit history from utility payment records, rental payments, automobile insurance payments, or other means of direct access from the credit provider. The lender must document that the providers of nontraditional credit do, in fact, exist and verify the credit information. Documents confirming the existence of a nontraditional credit provider may include a public record from the state, county, or city records, or other means providing a similar level of objective confirmation. To verify the credit information, lenders must use a published address or telephone number for that creditor.

As an alternative, the lender may elect to use a nontraditional mortgage credit report developed by a credit-reporting agency, provided that the credit reporting agency has verified the existence of the credit providers and the lender verifies that the nontraditional credit was extended to the applicant. The lender must verify the credit using a published address or telephone number to make that verification.

The basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts, and then revolving accounts. Generally, an individual with no late housing or installment debt payments should be considered as having an acceptable credit history, unless there is major derogatory credit on his or her revolving accounts.

When reviewing the borrower's credit and credit report, the lender must pay particular attention to the following:

- A. Previous Rental Or Mortgage Payment History.** The payment history of the borrower's housing obligations holds significant importance in evaluating credit. The lender must determine the borrower's payment history of housing obligations through either the credit report, verification of rent directly from the landlord (with no identity-of-interest with the borrower) or verification of mortgage directly from the mortgage servicer, or through canceled checks covering the most recent 12-month period.
- B. Recent and/or Undisclosed Debts.** The lender must ascertain the purpose of any recent debts, as the indebtedness may have been incurred to obtain part of the required cash investment on the property being purchased. Similarly, the borrower must provide a satisfactory explanation for any significant debt that is shown on the credit report but not listed on the loan application. The borrower must explain in writing all inquiries shown on the credit report in the last 90 days.
- C. Collections and Judgments.** Court-ordered judgments must be paid off before the mortgage loan is eligible for FHA insurance endorsement. (An exception may be made if the borrower has agreed with the creditor to make regular and timely payments on the judgment and documentation is provided that the payments have been made in accordance with the agreement.) FHA does not require that collection accounts be paid off as a condition of mortgage approval. Collections and judgments indicate a borrower's regard for credit obligations and must be considered in the analysis of creditworthiness with the lender documenting its reasons for approving a mortgage where the borrower has collection accounts or judgments. The borrower must explain in writing all collections and judgments.
- D. Previous Mortgage Foreclosure.** A borrower whose previous principal residence or other real property was foreclosed or has given a deed-in-lieu of foreclosure within the previous three years is generally not eligible for a new FHA-insured mortgage. However, if the foreclosure was the result of documented extenuating circumstances that were beyond the control of the borrower and the borrower has reestablished good credit since the foreclosure, the lender may grant an exception to the three-year requirement. Extenuating circumstances include serious illness or death of a wage earner, but do not include the inability to sell the house because of a job transfer or relocation to another area.
- E. Bankruptcy.** A Chapter 7 bankruptcy (liquidation) does not disqualify a borrower from obtaining an FHA-insured mortgage if at least two years have elapsed since the date of the discharge of the bankruptcy. Additionally, the borrower must have reestablished good credit or chosen not to incur new credit obligations. The borrower also must have demonstrated a documented ability to responsibly manage his or her financial affairs. An elapsed period of less than two years, but not less than 12 months, may be acceptable if the borrower can show that the bankruptcy was caused by extenuating circumstances beyond his or her control and has since exhibited a documented ability to manage his or her financial affairs in a responsible manner. Additionally, the lender must document that the borrower's current situation indicates that the events that led to the bankruptcy are not likely to recur.

A Chapter 13 bankruptcy does not disqualify a borrower from obtaining an FHA-insured mortgage provided the lender documents that one year of the payout period under the bankruptcy has elapsed and the borrower's payment performance has been satisfactory (i.e., all required payments made on time). In addition, the borrower must receive permission from the court to enter into the mortgage transaction.
- F. Consumer Credit Counseling Payment Plans.** Participation in a consumer credit counseling payment program does not disqualify a borrower from obtaining an FHA-insured mortgage provided the lender documents that one year of the pay-out period has elapsed under the plan and the borrower's payment performance has been satisfactory (i.e., all required payments made on time). In addition, the borrower must receive written permission from the counseling agency to enter into the mortgage transaction.