

RD AN No. 4441 (1980-D)
May 7, 2009

TO: All State Directors
Rural Development

ATTENTION: Rural Housing Program Directors,
Guaranteed Loan Coordinators,
Area Directors and Area Specialists

FROM: James C. Alsop (*Signed by James C. Alsop*)
Acting Administrator
Housing and Community Facilities Programs

SUBJECT: Single Family Housing Guaranteed Loan Program
Qualifying for Reduced Documentation when Requesting the
Conditional Commitment for Loan Note Guarantee by Utilizing
Credit Scores

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to affirm 620 as the minimum Fair Isaacs & Company (FICO) credit score required for underwriters to utilize streamlined documentation for manually underwritten guaranteed loan files. The term “streamlined” refers only to the amount of documentation to be submitted by the lender requesting a “Conditional Commitment for Loan Note Guarantee.” Streamlined documentation does not imply a no cost loan, no documentation, or limited underwriting. This guidance also applies to loan files that receive a “Refer” or “Refer with Caution” underwriting recommendation through the Guaranteed Underwriting System (GUS). This Administrative Notice is effective immediately for all Guaranteed loan requests for which a conditional commitment has not been issued.

EXPIRATION DATE:
May 31, 2010

FILING INSTRUCTIONS:
Preceding RD Instruction 1980-D

COMPARISON WITH PREVIOUS AN:

This AN replaces AN No. 4346, dated March 28, 2008. This AN includes updated guidance for manually underwritten guaranteed loans with credit scores above 620, guidance for credit scores of 619 and below, and applications with no credit scores.

BACKGROUND:

The Single Family Housing Guaranteed Loan Program (SFHGLP) continues to evaluate both loan performance and the real estate lending environment. Credit scores continue to impact the underwriting decision. Regardless of the credit score, lenders are responsible for evaluating all risk factors in each loan file and determining the impact on the underwriting decision.

Lenders should judiciously evaluate and carefully screen the credit histories of applicants with credit scores of 619 and below, for manually underwritten Guaranteed loan files. GUS loan files that receive an underwriting recommendation of “Refer” or “Refer with Caution” require a full manual underwriting review.

IMPLEMENTATION RESPONSIBILITIES:

Credit scores are an essential part of developing the comprehensive risk assessment of a proposed mortgage. Credit scores are based on a single credit file for the applicant that is obtained from one of three credit repositories. Due to model differences, each repository may differ in the amount of information in the “in-file” report. Therefore, lenders should obtain a minimum of two scores enabling them to select a single applicable score for underwriting the application.

Selecting Credit Scores

When reviewing eligible credit reports, select the correct credit for underwriting per these guidelines:

- Three scores: Select the middle score
- Two scores: Select the lowest score
- One score: Does not qualify for streamlined documentation
- No score: Does not qualify for streamlined documentation

Example: Proper selection, of the applicable credit score, for multiple applicants:

Applicant A: Credit scores reported: 750, **721**, 713

Applicant B: Credit scores reported: **619**, 633

Each applicant is treated separately. If the applicant has a score higher than 620 and the co-applicant has a score lower than 620, then the applicant qualifies for streamlined documentation, but the co-applicant’s credit history should be carefully examined.

Per the guidelines outlined in this AN, the underwriter must submit documentation for Applicant B, which corresponds to a credit score of 619.

A Non-Traditional Mortgage Credit Report (NTMCR) will be required for one score and no score credit reports. The NTMCR will serve as a substitute for a traditional credit report for borrowers who do not have sufficient credit history or have not established sufficient traditional credit references. In no case will the NTMCR be utilized to enhance the traditional credit history of borrowers with poor payment records.

Streamlined Documentation for Credit Scores of 620 and Above

Lenders must review and consider the entire credit history of each applicant regardless of credit score. For individual applicants or multiple applicants with representative credit scores of 620, and higher, lenders may take advantage of streamlined documentation when submitting underwritten loan packages to Rural Development requesting a Conditional Commitment for Loan Note Guarantee. The presence of a 620 credit score does not relieve the lender from the due diligence of sound underwriting. A lender's permanent case file must contain a thorough rationalization for approving a mortgage when requesting a Conditional Commitment for Loan Note Guarantee.

Loan files that qualify for streamlined documentation offer lenders the ability to retain documentation of adverse credit that has been reviewed and deemed acceptable by the underwriter in the lender's permanent loan case file.

A lender shall not be required to provide adverse credit history waivers for adverse credit waived by the underwriter to Rural Development in the loan package when requesting a Conditional Commitment for Loan Note Guarantee for the following items:

- Incidents of more than one debt payments being more than 30 days late if the incidents have occurred within the last 12 months. This includes more than one late payment on a single account.
- Outstanding tax liens or delinquent government debts with no satisfactory arrangements for payments, no matter what their age as long as they are currently delinquent and/or due and payable.
- A court-created or affirmed obligations (judgment) caused by nonpayment that is currently outstanding or has been outstanding with the last 12 months.
- Accounts that were converted to collection within the last 12 months (utility bills, hospital bills, etc.); outstanding collection accounts with no satisfactory arrangements for payments, no matter what their age, as long as they are currently delinquent and/or due and payable.
- Any debts written off within the last 36 months.
- A lender shall not be required to document or provide applicant rent payment history to Rural Development as long as none of the adverse credit instances listed below under "Exception" is present.

Exception: Streamlined documentation is not applicable to credit files that contain any of the following adverse credit. Follow the documentation requirements noted below regarding applicants with credit scores between 619 – 581.

- A foreclosure within the past 3 years.
- A bankruptcy.
 - Chapter 7 – Discharged within the past 3 years
 - Chapter 13 – A completed debt restructuring plan within the previous 12 months prior to application
- Late mortgage payments in the most recent 12 months.

A credit score of 620, and above, is **not** an automatic loan approval for a Guaranteed loan. All credit must be reviewed by the underwriter and contain sufficient information for the underwriter to reach an informed decision about whether to approve the mortgage.

Applicants with Credit Scores of 619 - 581

Based upon the portfolio review of SFHGLP loans, applicants with credit scores of 619, or below, have a statistically higher likelihood of default. This does not mean all applicants with credit scores of 619, and below, are poor credit risks and should be automatically rejected. Many loans with challenging credit in the past are paid as agreed. The decision to approve a loan application is the responsibility of the lender. However, underwriters must retain documented credit waivers outlining their justification for approval of the mortgage in their permanent loan case files **and** provide this documentation to Rural Development. Underwriters should be especially cautious of layered risks in addition to the identified adverse credit mentioned earlier in this notice which include, but are not limited to:

Adverse credit history waivers:

Approved by the lender, documentation submitted to Rural Development

If the lender waives any adverse credit for loan approval, for any instance of derogatory credit outlined in RD Instruction 1980-D, Section 1980.345(d), **the lender must secure documentation evidencing that the circumstances surrounding the adverse information were temporary in nature, and were beyond the applicant's control, and have been removed so their reoccurrence is unlikely.** The credit waiver issued by the underwriter must adequately address the above qualifications. Alternately, the lender must secure documentation evidencing that the delinquency arose from a justifiable dispute related to defective goods or services.

Ratio waivers:

Requested by the lender, approved by Rural Development

Ratio waivers should be avoided unless strong compensating factors are present (i.e. Principal, Interest, Taxes, and Insurance (PITI) is comparable to current housing expense, strong job history, conservative use of credit, demonstrated ability to accumulate reserves, etc.). A ratio waiver request must be submitted to Rural Development, in writing, with the compensating factors listed to support the request. The recommended method to document the basis for loan approvals involving a request for ratio waivers is the Underwriting Transmittal Summary submitted to Rural Development when requesting the Conditional Commitment.

Payment Shock (when additional risk layers are present):

Approved by the lender, documentation submitted to Rural Development

Lenders should be cautious when applicants live rent free, do not have an established rental history to verify repayment ability, or the proposed PITI is 100 percent, or greater, of the current rent or housing expense. Documentation of compensating factors offsetting payment shock will be retained in the lender's permanent case file and submitted to Rural Development when requesting the Conditional Commitment. When payment shock is the only risk factor in a loan file, no documentation is required from the lender.

Rent History Verification (VOR):

Reviewed and approved by the lender, documentation submitted to Rural Development

Lenders are required to obtain a Verification of Rent (VOR), or similar, documentation when available for all applicants with credit scores of 619, and below, and for applicants with credit scores of 620, and above, that do not meet the requirements for streamlined documentation. A 12 month history is most desired, however, any length of payment history should be considered. Written verifications from third party sources are preferred, but 12 months of cancelled checks or money order receipts covering the most recent 12 month period will also indicate a satisfactory payment history. Documentation will be retained in the lender's permanent case file and submitted to Rural Development when requesting the Conditional Commitment.

Repayment income or job stability:

Approved by the lender

Many components make up income potential – the borrower's occupation, employment tenure, opportunities for future advancement, educational background and occupational training. The lender is responsible for determining

the adequacy and continuation of the applicant's income. The lender's permanent case file will reflect the analysis and approval of stable income and/or repayment income in accordance with RD Instruction 1980-D, Section 1980.345, and 1980.347.

Applicants with Credit Scores of 580 and below

Loans with credit scores of 580, and below, are very high risk and exhibit a much higher rate of default. Lenders should not approve loans with credit scores of 580, and below, if they exhibit any of the indicators of unacceptable credit per RD Instruction 1980-D, Section 1980.345(d), which include:

- Incidents of more than one debt payment being more than 30 days late, if the incidents have occurred within the last 12 months. This includes more than one late payment on a single account.
- Loss of security due to a foreclosure, if the foreclosure has occurred within the last 36 months.
- Outstanding tax liens or delinquent government debts with no satisfactory arrangements for payments, no matter what their age, as long as they are currently delinquent and/or due and payable.
- A court-created or affirmed obligations (judgment) caused by nonpayment that is currently outstanding or has been outstanding with the last 12 months.
- Two or more rent payments paid 30 days or more past due within the last 3 years.
- Accounts which have been converted to collection within the last 12 months (utility bills, hospital bills, etc.).
- Outstanding collection accounts, with no satisfactory arrangements for payments, no matter what their age, as long as they are currently delinquent and/or due and payable.
- Any debts written off within the last 36 months.
- Bankruptcy discharged less than 36 months (Chapter 7); or, a debt restructuring plan completed less than 12 months (Chapter 13).

Additional risk layering in addition to the lower score is not recommended.

SUMMARY

Guaranteed loan portfolio performance and current real estate market conditions reveal a need to revisit acceptable parameters for SFHGLP loans. Credit scores are excellent indicators of acceptable credit; however, the credit score alone does not always give an accurate indication of an applicant's ability and willingness to repay a mortgage loan. **The lender's permanent case file must contain sufficient justification by the underwriter for approving the loan regardless of credit score.** The Uniform Underwriting Transmittal Summary is the recommended method to document this justification. The analysis should include an assessment of any compensating factors, or

credit history explanations that establish the applicant's ability and willingness to repay the proposed loan as agreed. SFHGLP loans may be rejected based on lack of repayment ability, lack of adequate and dependable income, inadequate credit history, or collateral that does not meet the required standards.

If a loan qualifies for streamlined documentation, yet displays inaccuracies in the data submitted, Rural Development reserves the right to request supporting documentation from the lender to support the Agency's approval of a Conditional Commitment request for a Loan Note Guarantee. Additionally, Rural Development may review loans developed by newly eligible lenders and/or underwriters to assure compliance with, and understanding of Agency regulations.

Age of Credit Documents

Credit documentation must be no more than 120 days old on the date the note is signed. However if the property is new construction, the documents may be up to 180 days old.

Lender Monitoring

On an ongoing basis, Agency field staff should monitor originating lenders for adherence to SFHGLP loan underwriting requirements, including the standards outlined in this AN. Field staff conducting lender origination monitoring reviews should pay special attention to credit scores when reviewing first year delinquencies and early payment defaults.

Questions regarding this AN may be directed to Kristina Zehr at (309) 452-0830, ext. 111, or Joaquin Tremols at (202) 720-1452. Their respective email addresses are kristina.zehr@wdc.usda.gov and joaquin.tremols@wdc.usda.gov.

Attachment

Single Family Housing Guaranteed Loan Program Credit Score Documentation Matrix

Reduced documentation only refers to the documentation submitted to Rural Development for Conditional Commitment for Loan Note Guarantee. In order for a lender to approve and issue a credit waiver, lenders must secure documentation evidencing the circumstances surrounding the adverse information was temporary in nature, **and** was beyond the applicant's control, **and** has been removed so their reoccurrence is unlikely.

Loan Characteristic	Credit Score 620 and above	Credit Score 619-581	Credit Score 580 and below
Payment Shock (when additional risk layers are present. Payment shock by itself is not a risk layer)	Documented compensating factors from approving underwriter submitted to RD. Lender retains supporting documentation.	Documented compensating factors from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for waiver
Verification of Rent (VOR)	No documentation necessary to be submitted to RD if the applicant(s) qualify for streamlined documentation.	Lender reviews and approves VOR. Submits VOR to RD.	Lender reviews and approves VOR. Submits VOR to RD.
Foreclosure within past 36 months	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Chapter 7 Bankruptcy discharged in past 36 months	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Chapter 13 Debt Restructuring Plan in past 12 months	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Late Mortgage Payments in the past 12 months	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Late Debt Payments: More than one debt more than 30 days late within last 12 months. Include more than 1 late payment on a single account.	No documentation necessary to be submitted to RD, if file is approved by underwriter.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Tax Liens/Government debts: No payment arrangements, currently due	No documentation necessary to be submitted to RD, if file is approved by underwriter.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Collection Accounts: Any outstanding collections with no payment arrangements currently due	No documentation necessary to be submitted to RD, if file is approved by underwriter.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Accounts Converted to Collections: Accounts converted to collection within the last 12 months	No documentation necessary to be submitted to RD, if file is approved by underwriter.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Court ordered judgments: Currently outstanding within the last 12 months	No documentation necessary to be submitted to RD, if file is approved by underwriter.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver
Debts Written Off: Within last 36 months	No documentation necessary to be submitted to RD, if file is approved by underwriter.	Documented Credit Waiver from approving underwriter submitted to RD. Lender retains supporting documentation.	Ineligible for credit waiver