

VA Lenders Handbook (VA Pamphlet 26-7), Chapter 4, Topic 7 — Credit History - Required Documentation and Analysis

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7. Credit History – Required Documentation and Analysis Change Date a. Credit Report Standards February 22, 2019 • This chapter has been revised in its entirety. Credit Reports used in analyzing VA loans must be either Three-file Merged Credit Reports (MCR), or Residential Mortgage Credit Reports (RMCR). The credit report must be less than 120-days old (180 days for new construction). For automatically closed loans and prior approval loans, the date of the credit report must be within 120 days of the date the note is signed (180 days for new construction). If an RMCR is used, the standards applicable to a RMCR include, but are not limited to, the following: • The report must be prepared by a reputable credit reporting agency. • Each account with a balance must have been checked with the creditor within 90 days of the date of the credit report. For each debt listed, the report must provide the creditor's name, date the account was opened, high credit, current status, required payment, unpaid balance, and payment history. The report must name at least two national repositories of credit records contacted for each location in which the borrower has resided during the most recent 2 years (separate repository inquiries are required for any co-borrowers with individual credit records). The report must include all available public records information that is not considered obsolete under the Fair Credit Reporting Act (15 U.S.C. § 1681) such as bankruptcies, judgments, law suits, foreclosures and tax liens. The RMCR must be an original or electronic report, with no erasures, whiteouts, or alterations. The report must contain a 24-month employment and residency history. VA may decline to accept a credit report which does not meet these standards. If possible, the cost of the credit report must be listed on the credit report. If not possible, an itemized invoice identifying the borrower(s) is required to verify the cost on the Closing Disclosure Statement (CD) when charging the borrower for the credit report. Continued on next page VA Pamphlet 26-7, Revised Chapter 4: Credit Underwriting 4-50 7. Credit History – Required Documentation and Analysis, continued b. How to Analyze Credit The borrower's past repayment practices on obligations is the best indicator of his or her willingness to repay future obligations. Emphasis should be on the borrower's overall payment patterns rather than isolated occurrences of unsatisfactory repayment. Determine whether the borrower (and spouse, if applicable) is a satisfactory credit risk based on a careful analysis of the credit report and other credit data. VA does not have a minimum credit score requirement. Rent and Mortgage Payment History The borrower's most recent 24-month rental history and any outstanding, assumed, or recently retired mortgages must be verified and rated. Housing expense payment history is often a primary indicator of how motivated the borrower is to make timely mortgage payments in the future. Absence of Credit History For borrower(s) with no established credit history, base the determination on the borrower's payment record on alternative or nontraditional credit directly from the borrower or creditor in which a payment history can be verified. Absence of a credit history is not generally considered an adverse factor. It may result when: • borrower(s) has not yet developed a credit history, • borrower(s) has routinely used cash rather than credit,

and/or • borrower(s) has not used since some disruptive credit event such as bankruptcy or debt pro-ration through consumer credit counseling. Accounts in the Spouse's Name See Topic 2, subsection c in this chapter for ECOA and consideration of the spouse's credit history. Continued on next page VA Pamphlet 26-7, Revised Chapter 4: Credit Underwriting 4-51 7. Credit History – Required Documentation and Analysis, continued b. How to Analyze Credit, continued Adverse Credit Data In circumstances not involving bankruptcy, satisfactory credit is generally considered to be re-established after the borrower(s), have made satisfactory payments for 12 months after the date the last derogatory credit item was satisfied. If a credit report reveals numerous unpaid collections and/or accounts that are not being paid timely, including some which have been outstanding for many years, then once the borrower has satisfied the obligations, and then makes timely payments on subsequent obligations for at least 12 months, satisfactory credit is considered re-established. Collection Accounts Isolated collection accounts do not necessarily have to be paid off as a condition for loan approval. A credit report may show numerous satisfactory accounts and one or two unpaid medical (or other) collections. In such instances, while it would be preferable to have collections paid, it would not necessarily be a requirement for loan approval. However, collection accounts must be considered part of the borrower's overall credit history and unpaid collection accounts should be considered open, recent credit. Borrowers with a history of collection accounts should have re-established satisfactory credit in order to be considered a satisfactory credit risk. While VA does not require that collection accounts be paid-off prior to closing if the borrower's overall credit is acceptable, an underwriter must address the existence of the collection account(s) with an explanation on VA Form 26- 6393, Loan Analysis, for excluding the negative credit history they represent. If the collection account is listed on the credit report with a minimum payment, then the debt should be recognized at the minimum payment amount. Continued on next page VA Pamphlet 26-7, Revised Chapter 4: Credit Underwriting 4-52 7. Credit History – Required Documentation and Analysis, continued b. How to Analyze Credit, continued Charged off Accounts These accounts are typically collections in which the creditor is no longer pursuing collection of the account. The underwriter must address the circumstances regarding the negative credit history when reviewing the overall credit of the borrower(s). Disputed Accounts Lenders may consider a Veteran's claim of bona fide or legal defenses regarding unpaid debts except when the debt has been reduced to judgment. The underwriter should document the reason(s) for not considering an account on VA Form 26-6393, Loan Analysis. Judgments Account balances reduced to judgment by a court must either be paid in full or subject to a repayment plan with a history of timely payments. A history of timely payments would be generally considered as making 12 payments to reestablish credit. However, in certain cases when a judgment has only been in place for a few months, an underwriter could justify on VA Form 26-6393, Loan Analysis, a shorter repayment history if the documentation indicates the borrower immediately addressed the judgment after it was filed and began a repayment plan. Payoff of Unpaid or Untimely Debts For unpaid or debts that have not been paid timely, pay-off of these debts after the acceptability of a borrower's credit is questioned does not alter the unsatisfactory record of payment. A period of making timely payments on subsequent obligations for at least 12 months, then satisfactory credit is considered re-established. Continued on next page VA Pamphlet 26-7, Revised Chapter 4: Credit Underwriting 4-53 7. Credit History – Required Documentation and Analysis, continued b. How to Analyze Credit, continued Consumer Credit Counseling Plan If a borrower(s) has prior adverse credit and are participating in a Consumer Credit Counseling plan, they may be determined to be a satisfactory credit risk if they demonstrate 12 months' satisfactory payments and the counseling agency approves the new credit. If a

borrower(s) has good prior credit and are participating in a Consumer Credit Counseling plan, such participation is to be considered a neutral factor, or even a positive factor, in determining creditworthiness. Do not treat this as a negative credit item if the borrower entered the Consumer Credit Counseling plan before reaching the point of having bad credit.

Bankruptcy The fact that a bankruptcy exists in a borrower (or spouse's) credit history does not in itself disqualify the loan. Develop complete information on the facts and circumstances of the bankruptcy. Consider the reasons for the bankruptcy and the type of bankruptcy filing.

Bankruptcy Filed Under the Straight Liquidation and Discharge Provisions of the Bankruptcy Law (Petition under Chapter 7 of the Bankruptcy Code):

- If the bankruptcy was discharged more than 2 years ago from the date of closing for purchases and refinances, it may be disregarded.
- If the bankruptcy was discharged within the last 1 to 2 years, it is probably not possible to determine that the borrower or spouse is a satisfactory credit risk unless both of the following requirements are met:

Requirement Explanation

- 1 The borrower(s) had obtained consumer items on credit subsequent to the bankruptcy and has satisfactorily made the payments over a continued period.
- 2 The bankruptcy was caused by circumstances beyond the control of the borrower or spouse such as unemployment, prolonged strikes, medical bills not covered by insurance, and so on, and the circumstances are verified.

Divorce is not generally viewed as beyond the control of the borrower and/or spouse.

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7. Credit History – Required Documentation and Analysis, continued

b. How to Analyze Credit, continued

If the bankruptcy was discharged within the past 12 months, it will generally not be possible to determine that the borrower(s) is a satisfactory credit risk. If the bankruptcy was caused by failure of the business of a self-employed borrower, it may be possible to determine that the borrower is a satisfactory credit risk if all four of the following are met:

Requirement Explanation

- 1 The borrower obtained a permanent position after the business failed.
- 2 There is not any derogatory credit information prior to the self-employment.
- 3 There is not any derogatory credit information subsequent to the bankruptcy.
- 4 Failure of the business was not due to the borrower's misconduct.

Bankruptcy Petition Under Chapter 13 of the Bankruptcy Code This type of filing indicates an effort to pay creditors. Regular payments are made to a court-appointed trustee over a 2 to 3-year period or, in some cases, up to 5 years, to pay off scaled down or entire debts. If the borrower(s) has finished making all payments satisfactorily, the lender may conclude that the borrower has re-established satisfactory credit. If the borrowers) has satisfactorily made at least 12 months' worth of the payments and the Trustee or the Bankruptcy Judge approves of the new credit, the lender may give favorable consideration.

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7. Credit History – Required Documentation and Analysis, continued

b. How to Analyze Credit, continued

Foreclosures The fact that a home loan foreclosure (or deed-in-lieu or short sale in lieu of foreclosure) exists in a borrower(s) history does not in itself disqualify the loan. Develop complete information on the facts and circumstances of the foreclosure. You may disregard a foreclosure finalized more than 2 years from the date of closing. If the foreclosure was finalized within the last 1 to 2 years from the date of closing, it is probably not possible to determine that the borrower(s) is a satisfactory credit risk unless both of the following requirements are met:

The borrower (s) has obtained consumer items on credit subsequent to the foreclosure and has satisfactorily made the payments over a continued period, and

The foreclosure was caused by circumstances beyond the control of the borrower (s) such as unemployment; prolonged strikes, medical bills not covered by insurance, and so on, and the circumstances are verified.

If a foreclosure, deed in lieu, or short sale process is in conjunction with a bankruptcy, use the latest date of either the discharge of the bankruptcy or transfer of title

for the home to establish the beginning date of re-established credit. If there is a significant delay in the transfer of title, the lender should contact the RLC of jurisdiction for guidance. Deed in lieu or short sale For a deed in lieu or short sale, develop complete information on the facts and circumstances in which the borrowers) voluntarily surrendered the property. If the borrower's payment history on the property was not affected before the short sale or deed in lieu and was voluntarily communicating with the servicer or holder, then a waiting period from the date transfer of the property may not be necessary. If the foreclosure, deed and lieu or short sale was on a VA-guaranteed loan, then a borrower may not have full entitlement available for the new VA loan. Ensure that the borrower's COE reflects sufficient entitlement to meet any secondary marketing requirements of the lender. VA Pamphlet 26-7, Revised Chapter 4: Credit Underwriting 4-56

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