FHA Update #1

This information has been taken from FHA Mortgagee Letter 2008-11

HUD like FNMA and FHMLC has been very busy lately! They have recently come out with some significant changes to their guidelines. I have included some of the more significant changes that may affect the way you do business. For more information about these and other changes occurring with FHA go to www.HUD.gov

Nontraditional Credit Verification and Evaluation

The Federal Housing Administration (FHA) has long permitted mortgage lenders to establish a borrower's credit history through nontraditional means, through rental payments; utility bills; telephone and cellular phone services; etc. This practice is appropriate when the borrower has insufficient trade lines with Equifax, Experian, or TransUnion and a credit bureau score cannot be derived. However, nontraditional credit reports may not be used to enhance any poor credit history on a traditional credit report.

An acceptable non-traditional credit borrower will have three (3) credit references, including at least one from Group I, covering the most recent 12 months activity from date of application.
Group I references should be exhausted prior to considering Group II.

Group I

- Rental Housing Payments (*subject to independent verification if the borrower is a renter)*

  If the borrower is renting from a family member, request independent documents to prove regularity of payments, such as cancelled checks.
- Utility Company Reference such as gas, electricity, water, land-line home telephone service, cable TV *(if not included in the rental housing payment*)

Group II

- insurance coverage, i.e., medical, auto, life, renter's insurance (not payroll deducted)
- payment to child care providers – made to a business providing such services; school tuition;
- retail stores – department, furniture, appliance stores, specialty stores
- rent to own – i.e., furniture, appliances
- payment of that part of medical bills not covered by insurance
- Internet/cell phone services;
- Documented 12 month history of saving by regular deposits (at least quarterly/non-payroll deducted/no NSF checks reflected), resulting in an increasing balance to the account;
- Automobile leases, or a personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments.

Evaluating Nontraditional Credit

FHA prefers all nontraditional credit references be verified by a credit bureau and reported back to the lender as a nontraditional mortgage credit report (NTMCR) in the same manner as traditional credit references. If a method is used to verify credit information or rental references other than NTMCR, *all references obtained from individuals should be backed up with the most recent 12 months cancelled checks.*

A satisfactory credit history, at least 12 months in duration, is to include:

- No history of delinquency on rental housing payments
- No more than one 30-day delinquency on payments due to other creditors

- No collection accounts/court records reporting (other than medical) filed within the past 12 months

Insufficient Credit
If the borrower cannot establish 3 credit references, or otherwise having only Group II references. A satisfactory credit history, at least 12 months in duration, is to include:

- No more than one 30-day delinquency on payments due to any Group II reference
- No collection accounts/court records reporting (other than medical) filed within the past 12 months

In addition, for such borrowers, to enhance the likelihood of homeownership sustainability, FHA is providing the following underwriting guidance:

- **Qualifying ratios are to be computed only on those occupying the property and obligated on the loan, and may not exceed 31 percent for the payment-to-income ratio and 43 percent for the total debt-to-income ratio.** Compensating factors are not applicable for borrowers with insufficient credit references.
- **Borrowers should have two months of cash reserves following mortgage loan settlement from their own funds (no cash gifts from any source should be counted in the cash reserves for borrowers in this category).**

How does this change affect your clients…

FHA has long been famous for their lenient "Non-Occupant Co-Borrower" loan program…many refer to it as the FHA Kiddie-Condo. This program has always allowed a parent to completely income qualify for an FHA loan where the child would occupy the property. The program was especially popular around colleges as the child could be in school and not working and just satisfy the owner-occupancy requirement. Many times the child could be young (at least 18) and not have the standard credit history that is required by conventional lenders and you could document a Non-Traditional Credit Report for the borrower, this change will affect that scenario. As stated above, those who have non-traditional credit and are the OCCUPANT, they must now be able to qualify ON THEIR OWN and not exceed the 31% Housing Expense Ratio and 43% total Debt to Income Ratio and these ratios cannot be stretched and do not allow for compensating factors. Those borrowers who fit in this category must now ALSO have 2 months reserves after closing which cannot come from gift sources.

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