Mortgage Partnership Finance™

Focus on Credit and Liabilities

September 7, 2023

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Topics Covered

- Common Liability Types and Payment Considerations
- Credit Inquiries and Undisclosed Liabilities
- Non-Traditional Credit
- Adverse Credit Events
- Did you Know?

Before We Begin

Credit guidelines may vary between manually underwritten loans and loans underwritten with an automated underwriting system (AUS) like Desktop Underwriter® (DU®) and Loan Product Advisor® (LPA)

MPF® Traditional Products

- Manually underwritten loans follow what is published in the **MPF Traditional Selling Guide**.
- Loans underwritten with DU or LPA follow the applicable agency guidelines*.

MPF Xtra® Product

- Loans underwritten with DU follow the findings received and **Fannie Mae Guidelines**
- Manually underwritten using Fannie Mae Guidelines.
- LPA is not an accepted AUS under the MPF Xtra product

* Some overlays may apply. See the MPF Traditional Selling Guide for specifics related to the use of DU and LPA.

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Before We Begin

In July of 2023, Chapter 5 of the MPF Traditional Selling Guide was updated

- Chapter 5 covers all aspects of underwriting the borrower, including the section on borrower credit and liabilities.

- Many guidelines remained the same, but others were changed to mirror Fannie Mae's guidelines.

- The published guidelines are used for MPF Traditional product loans that are manually underwritten.

MPF Traditional Selling Guide
Underwriting the Borrower (FOR MORTGAGE LOAN APPLICATIONS PRIOR TO JULY 1, 2023)

MPF Traditional Selling Guide
Underwriting the Borrower (FOR MORTGAGE LOAN APPLICATIONS ON OR AFTER JULY 1, 2023)

What is a Debt-to-Income (DTI) Ratio?

Proposed PITIA* + Monthly Obligations ÷ Borrower's Gross Monthly Income = DTI

- **Manually underwritten MPF Traditional loans cannot exceed a total DTI ratio of _43_%.**
- **Manually underwritten MPF Xtra loans should not exceed a total DTI ratio of _36_% but if loans meet the credit score and reserve requirements outlined *in Fannie Mae's Eligibility Matrix,* they can go as high as _45_%.**
- **If using DU to underwrite a loan, the maximum DTI ratio is _50_%.**

*PITIA stands for principal, interest, taxes and assessments (if applicable).

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Common Liability Types and Payment Considerations

Knowledge Check

According to Experian, the average credit score in 2022 was 714. Match the generation with their average credit score

1. 742
2. 706
3. 687
4. 679

a. Gen Z
b. Baby Boomers
c. Gen X
d. Millennials

b., c., d., a.
Baby Boomers = 742
Gen X = 706
Millennials = 687
Gen Z = 679

Revolving Debts

Revolving debts – use the minimum payment due reflected on the credit report.

- If no payment is noted, use **5%** of the outstanding balance.

- If the outstanding balance is less than $200, unless otherwise noted, use a payment of **$10.00.**

- If the account is paid off by the borrower at or prior to closing, the payment is not required to be included in the debt-to-income ratio (DTI).

Debts repaid on a schedule other than monthly (i.e. annually or quarterly):

- Payments must be reflected as a monthly amount. For example, a debt paid on a quarterly basis must converted to a monthly amount for calculation purposes.

Open-Ended/30-Day Accounts

Denise and Dale have a $3,100 balance on their American Express card. Which of the following is true?

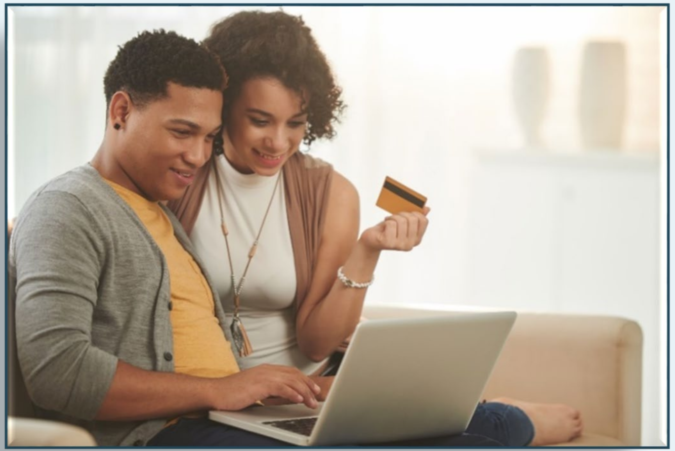
a. If it's a manually underwritten MPF Traditional loan, they must pay off the balance at or before closing.

b. If using DU or LPA* to underwrite the loan (Traditional or MPF Xtra), verify they have funds available in reserves to cover the payment.

c. If it's a manually underwritten MPF Traditional loan, verify that they have funds available in reserves to cover the payment.

d. If using DU, LPA* or manually underwriting, use 5% of the amount owed even if the balance/payment is showing $3,100.

b. and c. are true.



**LPA may only be used to underwrite MPF Traditional loans.*

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Installment Loans

Installment debt with <10 payments remaining may be excluded unless the payment affects the borrower's ability to repay the mortgage during the months immediately after closing, especially if the borrower has limited cash reserves.

Which of the following are considered installment debt?

a. Car loans
b. Timeshare loans reported as mortgages
c. Personal loans
d. Debts secured by a financial asset
e. Student loans

The answers are a., b., c., and e.

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Student Loans

Student loans with more than ten payments remaining must be included in the DTI ratio

- **MPF Traditional/MPF Xtra:** If no payment is provided on the credit report, 1% of the outstanding balance may be used
- The monthly payment that is on the borrower's student loan documentation (the most recent student loan statement) may also be used.
- If the borrower is on an income-driven plan and there is documentation to confirm that the payment is zero, a payment does not have to be held against them.
- If using LPA for MPF Traditional, the monthly payment amount reported on the credit report is zero, 0.5% of the outstanding loan balance may be used to calculate a payment.

Other Liabilities

Automobile Leases - must be considered no matter how many payments remain unless the borrower is able to provide **sound evidence** that they are not entering into a new lease.

Home Equity Lines of Credit (HELOCS)- use the payment provided on the credit report.

- If there's a balance but no payment provided, the *greater* of 5% of the outstanding balance or $10 must be used.
- A payment amount may also be evidenced by a monthly statement or loan documentation.
- A payment amount is not required for a HELOC with a zero balance.

Other Liabilities

Balloon-payment notes that come due within 12 months of the closing must be considered in the underwriting analysis.

Debts secured by financial assets (401k loans, margin accounts or CD loans) that can be repaid by liquidating the asset may be excluded from the DTI ratio.

- When listing the asset on the 1003, do not include the balance of the loan in the total value of the asset.

Alimony and Child Support

If more than ten alimony or child support payments remain, those payments must considered as part of the borrower's monthly obligations

- Voluntary payments do not need to be considered, only those that are part of a written legal agreement.
- For **alimony obligations only**, there is the option of reducing the borrower's monthly qualifying income by the amount of the monthly alimony payment.
- Watch for obligations that may be appearing on pay-stubs or deductions from bank accounts.

Business Debts

Randall has a Small Business Association (SBA) loan on his credit report.
What do you need to document in order to not hold this debt against him?

a. The account has no history of delinquent payments.
b. 12 months of cancelled checks (or equivalent) that show his business is paying the obligation.
c. Evidence that the obligation is considered in the cash flow analysis of the business.
d. All of the above.

The answer is d.

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Mortgage Payments

All existing mortgages must be current as of the application date, which means:

a. No more than 30 days have elapsed since the borrower's last paid installment.

b. No more than 45 days have elapsed since the borrower's last paid installment.

c. No more than 60 days have elapsed since the borrower's last paid installment.

b. No more than 45 days.

Knowledge Check

Christina and Alberto are purchasing a new home. They are closing on the new home 24 days before the sale of their current residence. Which of the following is true?

a. The PITIA for both homes must always be included in the DTI ratio.

b. The PITIA from their current home does not need to be included in the DTI ratio because it will be sold before their first payment is due.

c. The PITIA from their current home does not have to be included in the DTI if their current home is under contract and the purchaser has no financing contingencies.

d. The PITIA from their current home does not have to be considered if they have at least 6 months of reserves.

The answer is c.

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Credit Inquiries and Undisclosed Liabilities

Recent Credit Inquiries

All credit inquiries made within 90 days of the date of the credit report are considered recent and must be investigated

- Lenders must confirm any new accounts that may have been opened that are not listed on the credit report.
- If a new account has been established, the terms, balance and monthly payment must be obtained and verified.

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Undisclosed Liabilities

Borrowers are sometimes tempted to make substantial purchases for their new home which could cause a loan to be ineligible for purchase!

Starts with the Loan Officer/Originator

- Educate the borrower at the time of application.
- Most borrowers are unaware of the impact, especially after the loan has been “approved”.

Performing a soft-pull credit inquiry just prior to closing can help identify if new debt was established.

- Any large increases to existing revolving debt may have to be reviewed.
- Soft-pulls of credit do not effect the borrower’s credit score.

Non-Traditional Credit

Non-Traditional Credit

Non-traditional mortgage credit reports are permitted for borrowers with limited or no traditional credit history.

- If one or more borrowers do not have a credit score due to insufficient credit, the lender must establish an acceptable non-traditional credit profile.
- The borrower's non-traditional credit history should be verified directly from the borrower or the creditor, or by obtaining a nontraditional mortgage credit report from a consumer reporting agency.
- Non-traditional credit may not be utilized to off-set derogatory credit histories.
- **If all borrowers on the loan are relying solely on non-traditional credit to qualify (MPF Xtra or MPF Traditional with DU), at least one borrower must complete a homeownership education course prior to closing.**

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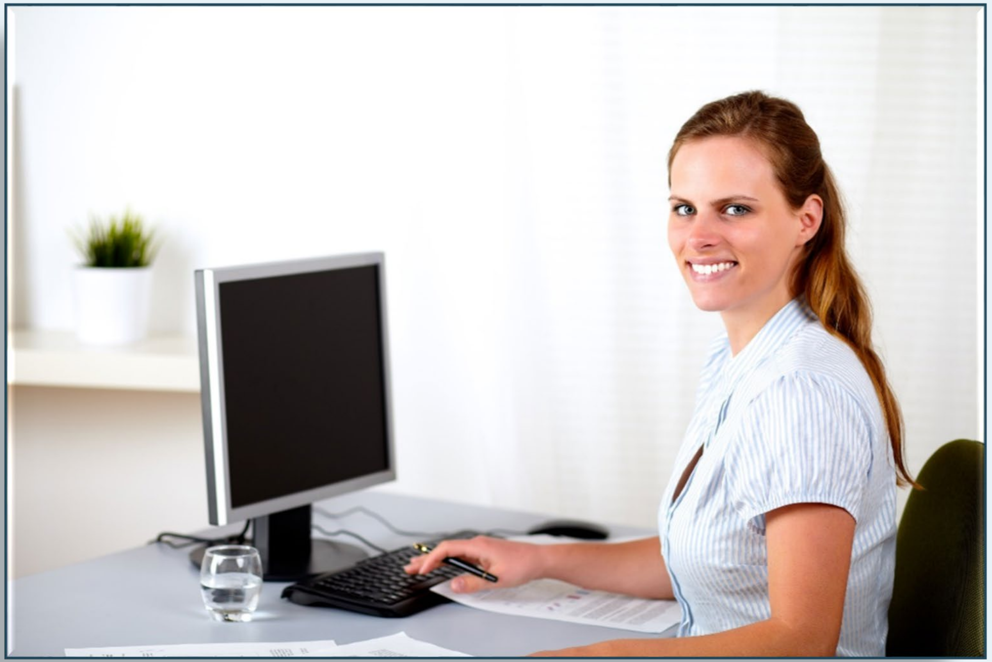
Non-Traditional Credit

Helene is processing a loan with two borrowers. One borrower has a credit score and the other does not.

If the loan is manually underwritten, how many non-traditional credit sources are needed for the borrower without a score?



a. Two

b. Four

c. None if the borrower with the credit score contributes more than 50% of the total qualifying income.

The answer is b.

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Non-Traditional Credit

Neal is processing an MPF Xtra loan for a purchase transaction. The borrower does not have a credit score.

Which of the following is FALSE if he uses DU to underwrite the loan?

a. There must be four non-traditional credit sources.
b. There must be two non-traditional credit sources.
c. The maximum DTI ratio is 40%.
d. The borrower must complete a homebuyer education course.

The answer is a.

Adverse Credit Events

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Past Due, Collections and Charge-Offs

- **MPF Traditional (manual underwriting)** requires that single events like a past judgment, tax lien, collection, non-medical charge-off, or repossession of $250 or more, and multiple events with past due amounts totaling more than $1,000 be paid in full at or prior to closing.

- If **DU or LPA** are used, and requires that the amount be paid, the AUS rule supersedes these requirements.*
  - Accounts reported as past due (not reported as collection accounts) must be brought current.
  - Outstanding collections or non-mortgage charge-offs do not have to be paid if the property is a one-unit primary residence.
  - Outstanding collections and non-mortgage charge offs totaling more than $5,000 must be paid in full prior to or at closing if the property is a two-four-unit or second home.

*If the account is marked *Paid By Close*, DU will issue a message stating that the collection must be paid.

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Federal Income Tax Installment Agreements

Jeff has entered into an installment agreement with the IRS to repay delinquent federal income taxes he incurred from a former business venture.

In order to include the payment in Jeff's monthly obligations, which of the following has to occur?

a. A copy of an approved IRS installment agreement showing the terms of repayment, payment amount and amount due must be obtained.

b. Documentation must be collected to show that the borrower is current on the payments.

c. At least six payments must have been made prior to closing.

d. There is no *Notice of Federal Tax Lien* recorded/filed against the borrower.

All but c. Only one payment needs to be made prior to closing.

Adverse Credit Events

Derogatory Event	Waiting Period	Waiting Period with Extenuating Circumstances
Chapter 7 or 11 Bankruptcy	Four years	Two years
Chapter 13 Bankruptcy	Two Years from discharge date Four Years from dismissal date	Two years from discharge date Two years from dismissal date
Multiple Bankruptcy Filings	Five years if more than one filing within the past seven years	Three years from the most recent discharge or dismissal date

Adverse Credit Events

Derogatory Event	Waiting Period	Waiting Period with Extenuating Circumstances
Foreclosure	**Seven years**	**Three years** Additional requirements after three years up to seven years: • 90% max LTV • Purchase, principal residence • Limited cash-out refi, all occupancy types *Note: the purchase of second homes, cash-out refinances (any occupancy type) are not permitted until the seven year waiting period has elapsed.*
Deed-in-Lieu or Pre-Foreclosure/Short Sale	**Four years**	**Two years**

Adverse Credit Events

Re-establishing credit following a major incident such as a bankruptcy or foreclosure-related action:

- A minimum of four accounts with at least one traditional credit reference on the credit report and one housing-related reference.
- At least three of the four accounts must have been opened and active for the most recent 24 months.
- For installment and revolving accounts, no more than two (2) 30-day late payments during the past 24 months.
- No housing late payments since the major credit incident.
- No new bankruptcies, foreclosures, unpaid judgments or collections.
- All payments on the credit report must be current at the time of application.

Borrowers who have been through credit counseling, require 12 months of re-established credit from the conclusion of the counseling.

Did You Know?

- Bankruptcies can stay on a credit report for ten years, while other items may drop off after seven years.
- Positive information can remain on a credit report indefinitely but most closed accounts that were paid as agreed age off after ten years.
- Bankruptcies can cause a score to drop 130 – 150 points. If credit is re-established, it can take around five years to go back to the pre-bankruptcy score range.
- Negative items vary. The Fair Reporting Credit Act (FRCA) covers most time limits for reporting negative items but they may vary due to state law.
- Late payments may be reported for up to seven years from when the delinquency occurred.

MPF Contacts and Resources

MPF Service Center

Email - MPF-Help@FHLBC.com
Hours - 8:30 am to 4:30 pm CST
Phone: (877) 345-2673

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