

# Focus on Credit and Liabilities

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# Underwriting Methods

## MPF® Traditional Products

- DU or LPA or manual underwriting may be used
- When using DU or LPA, follow the applicable guidelines (Fannie Mae or Freddie Mac) but be aware of any overlays listed in the MPF Traditional Selling Guide
- If manually underwriting, follow the published guidelines in the MPF Traditional Selling Guide

## MPF Xtra® Product

- DU or manual underwriting may be used
- Follow Fannie Mae's published guidelines for DU and manual underwriting but be aware of any overlays listed in the MPF Xtra Product Selling Guide

# Common Liability Types and Payment Considerations



# Take a Guess

According to Experian, which state has the highest amount of credit card debt?

- a. Alaska
- b. California
- c. Arizona
- d. Illinois
  
- e. Alaska. The average credit card debt is \$7,863

*Kansas (\$5,227) and Wisconsin (\$5,242) are the lowest*



# Revolving Accounts

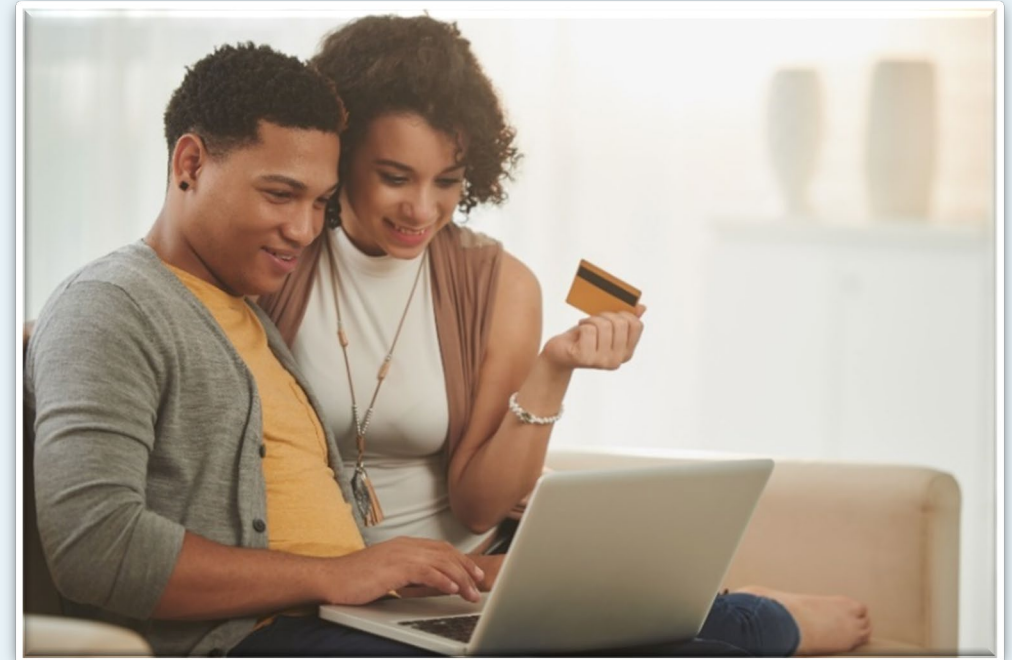


- Use the monthly minimum payment reflected on the credit report
- If there's no monthly payment listed on the credit report, use **5%** of the outstanding balance
- If the outstanding balance is less than \$200, unless otherwise noted, use a payment of **\$10.00**
- If the account balance is being paid off by the borrower at or prior to closing, the payment may be omitted from the borrower's monthly obligations

# Open-Ended/30-Day Accounts

**30-day accounts (i.e., some American Express accounts) require the balance to be paid in full every month**

- Verify that the borrower has sufficient funds to cover the balance
- Verified funds must be in addition to any funds needed to close and required reserves
- The same applies if there is no payment for the 30-day account reflected on the credit report



# 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 leases
- 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.





## Other Liabilities

Carl wants to take out a loan against his 401k to use towards his down payment and closing costs

Which of the following is true?

- a. Carl can't use the funds because they are borrowed
- b. You are not required to include the repayment in Carl's monthly debt obligations
- c. You are required to include the repayment in Carl's monthly debt obligations
- d. Evidence must be provided to show Carl's financial asset is collateral for the loan

**b and d are true**



# Student Loans

**Use the monthly payment reflected on the credit report**

**If no payment is reflected, use either 1% of the outstanding loan balance\* or a fully amortizing payment using the documented loan repayment terms**

**Is the loan in deferment?**

**If so, the payment must be included using 1% of the outstanding balance\* or a fully amortizing payment using the documented loan repayment terms**

**Income-driven payment plans with a \$0 payment reflected on the credit report**

**Obtain documentation to verify the actual payment is \$0. If that is confirmed, then no payment is required**

\*Freddie Mac permits a calculation based on 0.5% of the outstanding balance.  
See Freddie Mac Selling Guide 5401.2 for more details on student loan repayment requirements.

# Other Common Liabilities



## Car Lease Payments

- Considered in the borrower's monthly obligations regardless of the number of months remaining



## Home Equity Lines of Credit (HELOCs)

- Use the payment on the credit report or if not reflected, obtain borrower documentation
- If there's no balance, a payment does not have to be included in the borrower's monthly obligations

# Alimony and Child Support

If more than ten alimony or child support payments remain, those payments must be 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.
- Watch for obligations that may be appearing on pay-stubs or deductions from bank accounts.

For **alimony or separate maintenance**, you have the option to reduce the qualifying income by the amount of the obligation in lieu of including it as a monthly payment

***This does not apply to child support payments***



# Business Liabilities

Randall has a Small Business Association (SBA) loan on his credit report. What do you need to document 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 the above

The answer is d.



# Sale of a Departure Residence

Christina and Albert are purchasing a new primary residence. They have a buyer for their home, but that closing is scheduled to occur after they close on the new home.

To exclude the PITI for the home they are selling, what documentation do you need?

- An executed sales contract for their current residence
- Evidence that any financing contingencies have been cleared



# Debts Paid By Others



What if a non-mortgage debt is split with another party?

If it's documented, can the borrower's obligation be reduced by the amount paid by the other party?

**No, it's all or nothing**

- The entire amount may be excluded with evidence that the other party has been paying the **full obligation** for at least the last 12 months
- There should not be any delinquent payments in the past 12 months
- The other party cannot have an interest in the subject transaction

# Debts Paid By Others

**What if my borrower is obligated on a mortgage that's paid by another party?**

**Is there a way to exclude that payment?**

- Like non-mortgage obligations, you'll need a 12-month history showing the other party is making the payments
- There can be no delinquent payments in the past 12 months
- The party making the payment(s) must be obligated on the debt
- The borrower can't use rental income from the property to qualify





# Debts Paid By Others

Robert owns a rental home with his sister, Lisa.

Lisa makes and claims the P&I payments, and Robert makes and claims the T&I payments. On Schedule E, they each claim 50% of the rents and other expenses.

Robert is your borrower so you:

- a. Use the income and expenses shown on Schedule E
  - b. Use 75% of the current lease and subtract the full PITI
  - c. Exclude the entire obligation because Lisa is making the P&I payment on time
  - d. Use the income and expenses on Schedule E and include the full PITI in your calculation
- b. When payments are split with another owner, it's best to utilize leases.



# Non-Traditional Credit

# Nontraditional Credit

**If it's confirmed that *one or more* of your borrowers does not have a credit score, you may establish an acceptable nontraditional credit history**

- The guidelines differ between manual underwriting and underwriting with DU/LPA
- We'll be discussing DU and MPF Traditional manual underwriting requirements\*

**What are some eligible credit reference types?**

- Utilities
- Medical insurance (not paid through payroll)
- Medical bill installment payments
- Cell phone payments
- School tuition payments
- Childcare
- Rent and renter's insurance
- Auto loans
- Voluntary payments to a payroll savings plan or stock purchase plan
- Voluntary payments to a checking or savings account

\*Freddie Mac guidelines may differ

# Using DU

## At least one borrower has no credit score, and another has a score

- 1-unit primary residences only and all borrowers must occupy the property
- Purchase or limited cash-out refinances only
- No high-balance loans
- Follow DU reserve requirements
- If the borrower(s) with the credit score has **more than 50%** of the qualifying income, a nontraditional credit history for the borrower(s) without a score isn't required. Otherwise, non-traditional credit histories for all borrowers without scores is required.

How many credit references does each borrower without a credit score need if the borrower with a score contributes **less** than 50% of the qualifying income?

**A minimum of 2 credit references**



# Using DU

## No borrower has a credit score

- 1-unit primary residences only and all borrowers must occupy the property
- Purchase or limited cash-out refinances only
- No high-balance loans
- Follow DU reserve requirements
- Nontraditional credit history must be documented for each borrower unless DU conducts a cash flow assessment and issues messaging that the third-party report may be used to satisfy the requirement.
- At least one borrower must complete a homebuyer education course

**How many credit references  
are typically required when no  
borrower has a credit score?**

**A minimum of 2 credit  
references**

# Manual Underwriting

## MPF Xtra\*

- 1-unit primary purchases and limited cash-out refinances only
- The maximum DTI is 36%
- There is no minimum reserve requirement if at least one borrower has a housing payment history, otherwise 12 months of reserves is required
- A nontraditional credit history must be established for each borrower without a credit score
- Non-occupant co-borrowers are permitted
- High balance loans are not permitted
- If all borrowers on the loan are relying on nontraditional credit, at least one borrower must complete a homebuyer education course

**One more credit reference question**

**How many credit references are required for manually underwritten loans?**

**4**

*\*MPF Traditional manual underwriting guidelines are similar. Homebuyer education or reserves are not currently required.*

# Nontraditional Credit References

Credit references from a creditor must include the following:

- Creditors name
- Name of the individual providing the reference
- Date the account was opened
- Amount of the highest credit
- Status of the account
- Required payment amount
- Unpaid balance
- Payment history

## True or False

It is permissible for a creditor to report an account status as *current, satisfactory, or paid as agreed*

**False.** The historical status should be provided as the number of days past due 0x30, 0x60, 0x90

# Nontraditional Credit References

**Can you obtain a nontraditional payment history from the borrower?**

**Yes, if the following standards are met**

**Documentation that describes the terms of the debt repayment with canceled checks or copies of bills marked “paid” for a consecutive period covering the past 12 months**

**Withdrawals or debits on the borrower’s bank statements that clearly show payee information and provide proof the payments were made consistently over the previous 12 months**



# Adverse Credit Events

# Past Due, Collections, and Charge-Offs

## MPF Traditional and MPF Xtra (manual underwriting)

Single events like a past judgment, tax lien, collection, charge-off, or repossession of \$250 or more, and multiple events with past due amounts totaling more than \$1,000 must be paid in full at or prior to closing

## DU or LPA

- 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
- Investment properties (MPF Xtra only) follow manual underwriting guidelines

# Federal Income Tax Installment Agreements

Jeff has delinquent federal income taxes he incurred from a former business venture. If he has an IRS installment plan, what is needed to consider a monthly payment (instead of paying it in full)?

- a. A copy of an approved IRS installment agreement showing the terms of repayment, payment amount and amount due
- b. Documentation to show that Jeff is current on the payments
- c. Make sure Jeff has made at least six payments
- d. Ensure there is no *Notice of Federal Tax Lien* recorded/filed against Jeff

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	<p><b>Three years</b></p> <p>Additional requirements after three years up to seven years:</p> <ul style="list-style-type: none"><li>• 90% max LTV</li><li>• Purchase, principal residence</li><li>• Limited cash-out refi, all occupancy types</li></ul> <p><i>Note: the purchase of second homes, cash-out refinances (any occupancy type) are not permitted until the seven-year waiting period has elapsed.</i></p>
Deed-in-Lieu or Pre-Foreclosure/Short Sale	Four years	<b>Two years</b>



## 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.