Chapter 4. Credit Underwriting

Overview

In this Chapter

This chapter contains the following topics.

1. How to Underwrite a VA-Guaranteed Loan

Change Date

April 10, 2009, Change 10

- This section has been updated to correct hyperlinks and to make minor grammatical edits.

a. VA Underwriting Standards

VA loans involve a veteran's benefit. Therefore, lenders are encouraged to make VA loans to all qualified veterans who apply.

VA's underwriting standards are intended to provide guidelines for lenders' underwriters as well as VA's underwriters. Underwriting decisions must be based on sound application of the underwriting standards, and underwriters are expected to use good judgment and flexibility in applying the guidelines set forth in the following pages.

b. Basic Requirements

By law, VA may only guarantee a loan when it is possible to determine that the veteran:

- is a satisfactory credit risk, and
- has present and anticipated income that bears a proper relation to the contemplated terms of repayment.

VA's underwriting standards are incorporated into VA regulations at 38 CFR 36.4337 and explained in this chapter. This chapter addresses the verifications, procedures, and analysis involved in underwriting a VA-guaranteed loan. It provides guidance on how to treat income, debts and obligations, credit history, and so on, and how to present and analyze these items on VA's loan analysis form. It does not deal with every possible circumstance that will arise; therefore, underwriters must apply reasonable judgment and flexibility in administering this important veteran's benefit.

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1. How to Underwrite a VA-Guaranteed Loan, Continued

c. Lender Responsibility

Lenders are responsible for:

- developing all credit information,
- properly obtaining all required verifications and the credit report,
- ensuring the accuracy of all information on which the loan decision is based,
- complying with the law and regulations governing VA's underwriting standards, and with VA's underwriting policies, procedures, and guidelines, and
- certifying as to compliance with all of the above.

d. Lender Procedures

Section 2 of chapter 5 provides an overview of all procedures which must be completed when making a VA loan. The procedures below address only the credit underwriting of the loan.

Step	Action
1	Initiate the VA and Credit Alert Interactive Voice Response System (CAIVRS) inquiries described in section 6 of this chapter.
2	Obtain all necessary verifications. The applicant's authorization can be obtained for each verification needed, or on one blanket authorization form (attach a copy of the blanket authorization to each verification requested, including VA Form 26-8937, Verification of VA Benefits, if applicable). The credit report and verifications can be ordered by the lender or its agent or a party designated by the lender to perform that function. However, these documents must always be delivered by the credit reporting agency or verifying party directly to the lender or its agent, and never to another party. That is, while a lender may delegate authority for a builder, realtor, or other person to order the report for the lender, the report may not be delivered to such builder, realtor, and so on, and may not pass through the hands of any such party or the applicant.
3	Compare similar information received from different sources and resolve any discrepancies. For example, the number of dependents provided on the Uniform Residential Loan Application, tax returns, credit report, and so on, should be the same. In addition, the status of debts provided on the URLA and credit report should be the same.

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1. How to Underwrite a VA-Guaranteed Loan, Continued

d. Lender Procedures (continued)

Step	Action
4	Complete VA Form 26-6393, Loan Analysis, in conjunction with a careful review of the loan application and supporting documentation. The form is not required for Interest Rate Reduction Refinancing Loans (except IRRRLs to refinance delinquent VA loans).
5	Indicate the loan decision in item 50 of the Loan Analysis after ensuring that the treatment of income, debts, and credit is in compliance with VA underwriting standards.
6	***Loans closed by an automatic lender*** The underwriter must certify review and approval of the loan by signing item 51 of the Loan Analysis (for Automated Underwriting cases, see section 8 of this chapter). ***Note***: For nonsupervised automatic lenders, line 51 signature must be a VA-approved underwriter. ***Prior approval loans*** The individual with authority to determine that the loan meets VA credit standards and should be submitted to VA, must sign item 51 of the Loan Analysis.
7	An officer of the lender authorized to execute documents and act on behalf of the lender must complete the following certification: “The undersigned lender certifies that the loan application, all verifications of employment, deposit, and other income and credit verification documents have been processed in compliance with 38 CFR Part 36; that all credit reports obtained in connection with the processing of this borrower’s loan application have been provided to VA; that, to the best of the undersigned lender’s knowledge and belief, the loan meets the underwriting standards recited in chapter 37 of Title 38 United States Code and 38 CFR Part 36; and that all information provided in support of this loan is true, complete and accurate to the best of the undersigned lender’s knowledge and belief.”

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1. How to Underwrite a VA-Guaranteed Loan, Continued

e. Underwriting Special Types of Loans

The underwriting standards and procedures explained in this chapter apply to these special types of loans generally. However, some special underwriting considerations also apply and can be found as follows:

Type of Loan	Chapter	Section
Joint Loans	7	1
Energy Efficient Mortgages (EEMs)	7	3
Graduated Payment Mortgages (GPMs)	7	7
Growing Equity Mortgages (GEMs)	7	8
Loans Involving Temporary Interest Rate Buydowns	7	9
Farm Residence Loans	7	10

f. Refinancing Loans

While the underwriting standards detailed in this chapter apply to "cash-out" refinances, IRRRLs generally do not require any underwriting.

IRRRLs made to refinance VA loans 30 days or more past due must be submitted to VA for prior approval. It must be reasonable to conclude that:

- the circumstances that caused the delinquency have been corrected, and
- the veteran can successfully maintain the new loan.

Reference: See chapter 6 for details on all types of refinancing loans.

2. Income

Change Date

April 10, 2009, Change 10

- This section has been updated to correct hyperlinks and to make minor grammatical edits.
- Subsection m has been updated by removing the requirement that lenders must obtain a statement regarding a person's membership in the Reserves or National Guard.

a. Underwriter's Objectives

Identify and verify income available to meet:

- the mortgage payment,
- other shelter expenses,
- debts and obligations, and
- family living expenses.

Evaluate whether verified income is:

- stable and reliable,
- anticipated to continue during the foreseeable future, and
- sufficient in amount.

b. Importance of Verification

Only verified income can be considered in total effective income.

c. Income of a Spouse

Verify and treat the income of a spouse who will be contractually obligated on the loan the same as the veteran's income.

To ensure compliance with the Equal Credit Opportunity Act (ECOA), do **not** ask questions about the income of an applicant's spouse unless the:

- spouse will be contractually liable,
- applicant is relying on the spouse's income to qualify,
- applicant is relying on alimony, child support, or separate maintenance payments from the spouse or former spouse, or
- applicant resides in a community property State or the security is in such a State.

Note: In community property States, information concerning a spouse may be requested and considered in the same manner as for the applicant, even if the spouse will not be contractually obligated on the loan.

Continued on next page

2. Income, Continued

d. ECOA Considerations

Restrict inquiries related to the applicant's spouse to the situations listed in the "Income of a Spouse" heading in this section.

Always inform the applicant (and spouse, if applicable) that they do not have to divulge information on the receipt of child support, alimony, or separate maintenance. However, in order for this income to be considered in the loan analysis, it must be divulged and verified.

Income cannot be discounted because of sex, marital status, age, race, or other prohibited bases under ECOA.

Treat income from all sources equally; that is, the fact that all or part of an applicant's income is derived from any public assistance program is not treated as a negative factor, provided the income is stable and reliable.

e. Income from Non-Military Employment

Verification: General Requirement
Verify a minimum of 2 years employment.

If the applicant has been employed by the present employer less than 2 years:

- verify prior employment plus present employment covering a total of 2 years,
- provide an explanation of why 2 years employment could not be verified,
- compare any different types of employment verifications obtained (such as, Verification of Employment (VOE), pay stubs, and tax returns for consistency), and
- clarify any substantial differences in the data that would have a bearing on the qualification of the applicant.

Verification: Employment Verification Services
Lenders may use VOEs supplied by an employment verification service only if VA has approved the use of VOEs from that particular provider. VA has approved "FULL" verifications of employment through "The Work Number for Everyone," a service of the TALX Corporation. (No pay stub is needed with the TALX verification.)

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2. Income, Continued

e. Income from Non-Military Employment (continued)

Verification: Standard Documentation
Acceptable verification consists of:

- VA Form 26-8497, Request for Verification of Employment, or any format which furnishes the same information as VA Form 26-8497, **plus**
- a pay stub if the employer normally provides one to the applicant.

If the employer does **not** indicate the probability of continued employment on the VOE, the lender is not required to request anything additional on that subject.

The VOE and pay stub must be no more than 120 days old (180 days for new construction).

- For loans closed automatically, the date of the VOE and pay stub must be within 120 days of the date the note is signed (180 days for new construction).
- For prior approval loans, the date of the VOE and pay stub must be within 120 days of the date the application is received by VA (180 days for new construction).

The VOE must be an original. The pay stub may be an original or a copy certified by the lender to be a true copy of the original.

Note: It is acceptable for Department of Defense civilian employees to provide computer generated pay stubs accessed through myPay (formerly known as E/MSS - Employee Member Self Service).

Verification: Additional Documentation for Persons Employed in the Building Trades or Other Seasonal or Climate-Dependent Work
In addition to the standard documentation (VOE and pay stub), obtain:

- documentation evidencing the applicant's total earnings year to date,
- signed and dated individual income tax returns for the previous 2 years, and
- if applicant works out of a union, evidence of the union's history with the applicant.

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2. Income, Continued

e. Income from Non-Military Employment (continued)

Verification: Alternative Documentation
Alternative documentation may be submitted in place of a VOE if the lender concludes that the applicant's income **is** stable, reliable, and anticipated to continue during the foreseeable future; that is, if the applicant's income qualifies as effective income. 2 years employment is not required to reach this conclusion.

Alternative documentation consists of:
- Pay stubs covering at least the most recent 30-day period.

Note: It is acceptable for Department of Defense civilian employees to provide computer generated pay stubs accessed through myPay (formerly known as E/MSS - Employee Member Self Service).

- W-2 forms for the previous 2 years.
- Telephone verification of the applicant's current employment.

Note: Document the date of verification and the name, title, and telephone number of the person with whom employment was verified.

If the employer is **not** willing to give telephone verification of applicant's employment or the pay stubs or W-2 forms are in any way questionable as to authenticity, use standard documentation. Alternative documentation cannot be used.

Pay stubs and W-2 forms may be originals or copies certified by the lender to be true copies of the originals.

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2. Income, Continued

e. Income from Non-Military Employment (continued)

Verification: Fax and Internet
Fax and Internet documentation may be submitted in place of a VOE if the lender concludes that the applicant's income **is** stable, reliable, and anticipated to continue during the foreseeable future; that is, if the applicant's income qualifies as effective income.

Fax and Internet documentation consists of:

- the same information contained in a standard VOE,
- clear identification of the employer and source of information, and
- name and telephone number of a person who can verify faxed information.

Lenders are responsible for ensuring the authenticity of the documents. For Faxed documents, review the "banner" information provided at the top of each page of the fax. For Internet documents, review the information contained on any headers/footers and the banner portion of the downloaded webpage(s). These pages must contain the uniform resource locator (URL) and the date and time printed. The documents should also be reviewed for errors such as incorrect area codes, unreadable names or income, etc.

Analysis: General Guidance
Income analysis is not an exact science. It requires the lender to underwrite each loan on a case-by-case basis, using:

- judgment,
- common sense, and
- flexibility, when warranted.

Analyze the probability of continued employment (that is, whether income is stable and reliable) by examining the:

- applicant's past employment record,
- applicant's training, education, and qualifications for his/her position,
- type of employment, and
- employer's confirmation of continued employment, if provided.

In the applicant's current position, 2 years of employment is a positive indicator of continued employment. It is **not** a required minimum and **not** always sufficient by itself to reach a conclusion on the probability of continued employment.

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2. Income, Continued

f. Analysis: Applicant Employed Less Than 12 Months

Generally, employment less than 12 months is **not** considered stable and reliable. However, it may be considered stable and reliable if the individual facts warrant such a conclusion. Carefully consider the employer's evaluation of the probability of continued employment, if provided.

Assess whether the applicant's training and/or education equipped him or her with particular skills that relate directly to the duties of his/her current position. This generally applies to skilled positions. Examples include nurse, medical technician, lawyer, paralegal, and computer systems analyst.

If the probability of continued employment is high based on these factors, then the lender may give favorable consideration to including the income in the total effective income. An explanation of why income of less than 12 months duration was used must accompany the loan submission.

If the probability of continued employment is good, but not as well supported, the lender may still consider the income if the applicant has been employed at least 6 months to partially offset debts of 10 to 24 months duration.

Determine the amount which can be used, based on such factors as:

- the employer's evaluation of the probability of continued employment, if provided, and
- the length of employment (for example, 10 months versus 6 months).

Note: Include an explanation with the loan submission.

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2. Income, Continued

g. Analysis: Recent History of Frequent Changes of Employment

Short-term employment in a present position combined with frequent changes of employment in the recent past requires special consideration to determine stability of income. Analyze the reasons for the changes in employment.

Reference: See section 4 of "Current Issues" for a discussion of frequent job changes by individuals with low-to-moderate incomes.

Give favorable consideration to changes for the purpose of career advancement in the same or related field.

Favorable consideration may not be possible for changes:

- with no apparent betterment to the applicant, and
- from one line of work to another.

If the lender includes applicant's income in effective income, an explanation must accompany the loan submission.

h. Income from Overtime Work, Part-time Jobs, Second Jobs, and Bonuses

Generally, such income cannot be considered stable and reliable unless it has continued (and is verified) for 2 years.

To include income from these sources in effective income:

- the income must be regular and predictable, and
- there must be a reasonable likelihood that it will continue in the foreseeable future based on
- its compatibility with the hours of duty and other work conditions of the applicant's primary job, and
- how long the applicant has been employed under such arrangement.

The lender may use this income, if it is not eligible for inclusion in effective income, but is verified for at least 12 months, to offset debts of 10 to 24 months duration. Include an explanation.

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2. Income, Continued

i. Income from Commissions

Verification
When all or a major portion of the applicant's income is derived from commissions, obtain the following documentation:

- VOE or other written verification which provides the following:
- the actual amount of commissions paid year-to-date.
- the basis for payment (that is, salary plus commission, straight commission, or draws against commission).
- when commissions are paid (that is, monthly, quarterly, semiannually, or annually).
- Individual income tax returns, signed and dated, plus all applicable schedules for the previous 2 years (or additional periods if needed to demonstrate a satisfactory earnings record).

Analysis
Generally, income from commissions is considered stable when the applicant has obtained such income for at least 2 years.

- Less than 2 years cannot usually be considered stable unless the applicant has had previous related employment and/or extensive specialized training.
- Less than 2 year can rarely qualify. In-depth development is required for a conclusion of stable income on less than 1 year cases.

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2. Income, Continued

j. Self-Employment Income

Verification
Obtain the following documentation:

- current financial statements prepared in a generally recognized format, including:
  - year-to-date profit and loss statement
  - current balance sheet

Note: The financial statements must be sufficient for a loan underwriter to determine the necessary information for loan approval. The lender may require accountant-prepared financial statements or financial statements audited by a Certified Public Accountant if needed to make such a determination due to the nature of the business or the content of the financial statements.

- individual income tax returns, signed and dated, plus all applicable schedules for the previous 2 years (or additional periods if needed to demonstrate a satisfactory earnings record).
- if the most recent year's tax return has not yet been prepared, provide a profit and loss statement for that year, and
- if the business is a corporation or partnership
  - copies of the signed federal business income tax returns for the previous 2 years plus all applicable schedules, and
  - a list of all stockholders or partners showing the interest each holds in the business.

Note: Obtain a written credit report on the business as well as the applicant as needed.

Analysis
Generally, income from self-employment is considered stable when the applicant has been in business for at least 2 years.

- Less than 2 years cannot usually be considered stable unless the applicant has had previous related employment and/or extensive specialized training.
- Less than 1 year can rarely qualify.
- In-depth development is required for a conclusion of stable income on less than 1 year cases.

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2. Income, Continued

j. Self-Employment Income (continued)

Analyze the general economic outlook for similar businesses to determine whether the business can be expected to generate sufficient income for the applicant's future needs.

If the business shows a steady or significant decline in earnings over the period analyzed, the reasons for such decline must be analyzed to determine whether the trend is likely to continue or be reversed.

If the business is unusual and it is difficult to determine the probability of continued operation, obtain an opinion on viability and future earnings, and an explanation of the function and financial operations of the business from a qualified party.

Depreciation claimed as a deduction on the tax returns and financial statements of the business may be included in effective income.

k. Active Military Applicant's Income

Verification
A military Leave and Earnings Statement (LES) is required instead of a VOE.

- The LES must furnish the same information as a VOE.
- The LES must be no more than 120 days old (180 days for new construction).
- For loans closed automatically, the date of the LES must be within 120 days of the date the note is signed (180 days for new construction).
- For prior approval loans, the date of the LES must be within 120 days of the date the application is received by VA (180 days for new construction).

The LES must be an original or a copy certified by the lender to be a true copy of the original.

Note: The Department of Defense provides service members access to a computer generated LES through myPay (formerly known as E/MSS - Employee Member Self Service). This type of LES is acceptable.

In addition, identify servicemembers who are within 12 months of release from active duty or end of contract term. Find the date of expiration of the applicant's current contract for active service on the LES (for an enlisted servicemember). For a National Guard or Reserve member, find the expiration date of the applicant's current contract.

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2. Income, Continued

k. Active Military Applicant's Income (continued)

Verification (continued)
If the date is within 12 months of the anticipated date that the loan will close, the loan package must also include one of the following four items, or combinations of items, to be acceptable:

- documentation that the servicemember has already re-enlisted or extended his/her period of active duty to a date beyond the 12-month period following the projected closing of the loan, or
- verification of a valid offer of local civilian employment following the release from active duty. All data pertinent to sound underwriting procedures (date employment will begin, earnings, and so on) must be included, or
- a statement from the servicemember that he/she intends to reenlist or extend his/her period of active duty to a date beyond the 12 month period, plus
- a statement from the servicemember's commanding officer confirming that:
  - the servicemember is eligible to reenlist or extend his/her active duty as indicated, and
  - the commanding officer has no reason to believe that such reenlistment or extension of active duty will not be granted, or
- documentation of other unusually strong positive underwriting factors, such as:
  - a downpayment of at least 10 percent,
  - significant cash reserves, and
  - clear evidence of strong ties to the community coupled with a nonmilitary spouse's income so high that only minimal income from the active duty servicemember is needed to qualify.

Analysis: Base Pay
Consider the applicant's base pay as stable and reliable except if the applicant is within 12 months of release from active duty.

- Analyze the additional documentation submitted.
- If the applicant will not be reenlisting, determine whether:
  - the applicant's anticipated source of income is stable and reliable, and/or
  - unusually strong underwriting factors compensate for any unknowns regarding future sources of income.

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2. Income, Continued

k. Active Military Applicant's Income (continued)

Analysis: Military Quarters Allowance
The lender may include a military quarters allowance in effective income if properly verified. In most areas there will be an additional variable housing allowance, which can also be included.

The military quarters and variable housing allowances are **not** taxable income.

Ensure that the applicant meets the occupancy requirements set forth in section 5 of chapter 3.

Verification: Subsistence and Clothing Allowances
Any subsistence (rations) and clothing allowances are indicated on the LES.

Analysis: Subsistence and Clothing Allowances
The lender may include verified allowances in effective income. These allowances are not taxable income.

Note: The clothing allowance generally appears on the LES as an annual amount. Convert it to a monthly amount for the loan analysis.

Verification: Other Military Allowances
To consider a military allowance in the underwriting analysis, obtain verification of the type and amount of the military allowance, and how long the applicant has received it.

Analysis: Other Military Allowances
Examples include propay, flight or hazard pay, overseas pay, and combat pay.

All of these are subject to periodic review and/or testing of the recipient to determine continued eligibility. These types of allowances are considered taxable income by the IRS, unlike housing, clothing, and subsistence allowances.

Military allowances may be included in effective income only if such income can be expected to continue because of the nature of the recipient's assigned duties.

Example: Flight pay verified for a pilot. If duration of the military allowance cannot be determined, this source of income may still be used to offset obligations of 10 to 24 months duration.

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2. Income, Continued

l. Income from Service in the Reserves or National Guard

Income derived from service in the Reserves or National Guard may be included in effective income if the length of the applicant's total active and Reserve/Guard service indicates a strong probability that the Reserve/Guard income will continue.

Otherwise, this income may be used to offset obligations of 10 to 24 months duration.

m. Recently Activated Members of the Reserve or National Guard

Lenders must consider if an applicant, whose income is being used to qualify for a loan, may have a change in income due to participation in a Reserves/ National Guard unit subject to activation.

If so, lenders must determine what the applicant's income may be if activated:

- **Reduced**, carefully evaluate the impact the reduction may have on the borrower's ability to repay the loan.
- **Increased**, consider the likelihood the income will continue beyond a 12-month period.

Example: If an activated reserve/guard member applies for a loan, they may present orders indicating their tour of duty is not to exceed 12 months. Under these circumstances lenders need to carefully evaluate both the present income (current employment) and expected income (reservist income) in terms of income stability and reliability.

There are no clear-cut procedures that can be applied to all cases. Evaluate all aspects of each individual case, including credit history, accumulation of assets, overall employment history, etc., and make the best decision for each loan regarding the use of income in qualifying for the loan.

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2. Income, Continued

m. Recently Activated Members of the Reserve or National Guard (continued)

It is very important that loan files be carefully and thoroughly DOCUMENTED, including any reasons for using or not using reservist income in these situations.

Weigh the desire to provide a veteran their benefit with the responsibility to ensure the veteran will not be placed in a position of financial hardship.

Lenders should contact the appropriate VA office if any questions arise in reference to unusual circumstances regarding a mobilized servicemember's income.

n. Income of Recently Discharged Veterans

Verification
Obtain verification of any of the following which apply:

- employment income

Reference: See "Income from Non-Military Employment" in this section for verification requirements.

- retirement income, and
- military separation payments.

If the applicant has been employed in a position for only a short time, obtain a statement from the employer that the applicant is performing the duties of the job satisfactorily and the probability of continued employment is favorable.

Analysis: Prospects for Continued Employment
Cases involving recently discharged veterans often require the underwriter to exercise a great deal of flexibility and judgment in determining whether the employment income will continue in the foreseeable future. This is because some veterans may have little or no employment experience other than their military occupation. Continuity of employment is essential for a veteran with no retirement income or insufficient retirement income to support the loan obligation.

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2. Income, Continued

n. Income of Recently Discharged Veterans (continued)

For recently discharged veterans who have been in their new jobs only a very short time, analyze prospects for continued employment as follows:

- If the duties the applicant performed in the military are similar or directly related to the duties of the present position, use this as one indicator that the employment is likely to continue.
- If the applicant's current job requires skills for which the applicant has had no training or experience, greater time in the current job may be needed to establish stability.

If the applicant's retirement income, compared to total estimated shelter expense, long-term debts, and family living expense is such that only minimal income from employment is necessary to qualify from the income standpoint, resolve doubt in favor of the applicant.

Examples:
Qualifying short-term employment - An applicant who was an airplane mechanic in the military is now employed as an auto mechanic or machinist.

Nonqualifying short-term employment - An applicant who was an Air Force pilot is now employed as an insurance salesperson on commission.

Most cases fall somewhere between these extremes. Fully develop the facts of each case in order to make a determination.

Apply the guidelines under "Self-Employment Income" in this section to a recently discharged veteran who is self-employed.

Analysis: Voluntary Separation Payments
Two types of voluntary separation payments are used to facilitate military downsizing:

(1) *Special Separation Benefit (SSB)*

- A one-time lump sum,
- Taxable in the year received, and
- Treat the same as any substantial cash reserve.

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2. Income, Continued

n. Income of Recently Discharged Veterans (continued)

(2) *Voluntary Separation Incentive (VSI)*

- Annual payments
- Taxable in the year received
- Include in effective income
- Calculated by multiplying the veteran's years of service times two
- Requires a minimum of 6 years service (equates to a minimum of 12 years annual payments)

If the veteran receives both VSI and VA disability compensation payments, the VSI is reduced by the amount of disability compensation. However, if the disability compensation is related to an earlier period of service and the VSI a later period of service, the VSI is **not** reduced by the amount of disability compensation.

VSI is reduced by the amount of any base pay or compensation a member receives for active or reserve service, including inactive duty training.
The veteran can designate a beneficiary for VSI payments in the event of death.

o. Rental Income

Verification: Multi-Unit Property Securing the VA Loan
Verify:

- cash reserves totaling at least 6 months mortgage payments (principal, interest, taxes, and insurance - PITI), and
- documentation of the applicant's prior experience managing rental units or other background involving both property maintenance and rental.

Analysis: Multi-Unit Property Securing the VA Loan
Include the prospective rental income in effective income only if:

- evidence indicates the applicant has a reasonable likelihood of success as a landlord, and
- cash reserves totaling at least 6 months mortgage payments are available.

The amount of rental income to include in effective income is based on 75 percent of:

- verified prior rent collected on the units (existing property), or
- the appraiser's opinion of the property's fair monthly rental (proposed construction).

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2. Income, Continued

o. Rental Income (continued)

Note: A percentage greater than 75 percent may be used if the basis for such percentage is adequately documented.

Verification: Rental of the Property Applicant Occupied Prior to the New Loan
Obtain a copy of the rental agreement on the property, if any.

Analysis: Rental of the Property Applicant Occupied Prior to the New Loan
Use the prospective rental income only to offset the mortgage payment on the rental property and only if there is no indication that the property will be difficult to rent. This rental income may **not** be included in effective income.

Obtain a working knowledge of the local rental market. If there is no lease on the property, but the local rental market is very strong, the lender may still consider the prospective rental income for offset purposes.

Verification: Rental of Other Property Not Securing the VA Loan
Obtain the following:

- documentation of cash reserves totaling at least 3 months mortgage payments (principal, interest, taxes, and insurance - PITI), and
- individual income tax returns, signed and dated, plus all applicable schedules for the previous 2 years, which show rental income generated by the property.

Analysis: Rental of Other Property Not Securing the VA Loan
Rental income verified as stable and reliable may be included in effective income. If there is little or no prior rental history on the property, make a determination based on review of:

- documentation of the applicant's prior experience managing rental units or other background involving both property maintenance and rental
- any leases on the property, and
- the strength of the local rental market.

Property depreciation claimed as a deduction on the tax returns may be included in effective income.

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2. Income, Continued

p. Alimony, Child Support, and Maintenance Payments

See "ECOA Considerations" in this section.

Verify the income if the applicant wants it to be considered. The payments must be likely to continue in order to include them in effective income.

Factors used to determine whether the payments will continue include, but are not limited to:

- whether the payments are received pursuant to a written agreement or court decree,
- the length of time the payments have been received,
- the regularity of receipt, and
- the availability of procedures to compel payment.

q. Automobile or Similar Allowances

Generally, automobile allowances are paid to cover specific expenses related to an applicant's employment, and it is appropriate to use such income to offset a corresponding car payment.

However, in some instances, such an allowance may exceed the car payment. With proper documentation, income from a car allowance which exceeds the car payment can be counted as effective income. Likewise, any other similar type of allowance which exceeds the specific expenses involved may be added to gross income to the extent it is documented to exceed the actual expense.

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2. Income, Continued

r. Other Types of Income

If it is reasonable to conclude that other types of income will continue in the foreseeable future, include it in effective income. Otherwise, consider whether it is reasonable to use the income to offset obligations of 10 to 24 months duration.

"Other" types of income which may be considered as effective income include, but are not limited to:

- pension or other retirement benefits,
- disability income,
- dividends from stocks,
- interest from bonds, savings accounts, and so on, and
- royalties.

The lender may include verified income from public assistance programs in effective income if evidence indicates it will probably continue for 3 years or more.

The lender may include verified workers' compensation income that will continue in the foreseeable future, if the veteran chooses to reveal it.

The lender may include verified income received specifically for the care of any foster child(ren). Generally, foster care income is to be used only to balance the expenses of caring for the foster child(ren) against any increased residual income requirements.

Do **not** include temporary income items such as VA educational allowances and unemployment compensation in effective income.

Exception:
If unemployment compensation is a regular part of the applicant's income due to the nature of his or her employment (for example, seasonal work), it may be included.

3. Income Taxes and Other Deductions from Income

Change Date

April 10, 2009, Change 10
- This section has been updated to make minor grammatical edits.

a. Income Tax and Social Security Deductions

Determine the appropriate deductions for Federal income tax and Social Security using the "Employer's Tax Guide," Circular E, issued by the Internal Revenue Service.

Determine the appropriate deductions for state and local taxes using similar materials provided by the states.

The lender may consider the applicant's potential tax benefits from obtaining the loan (for example, mortgage interest deduction) in the analysis. To do so:

- determine what the applicant's withholding allowances will be, using the instructions and worksheet portion of IRS Form W-4, Employee's Withholding Allowance Certificate, and
- apply that withholding number when calculating Federal and state income tax deductions.

Continued on next page

3. Income Taxes and Other Deductions from Income, Continued

b. Income Tax Credits from Mortgage Credit Certificates

Mortgage Credit Certificates (MCCs) issued by state and local governments may qualify a borrower for a Federal tax credit. The Federal tax credit is based on a certain percentage of the borrower's mortgage interest payment.

Lenders must provide a copy of the MCC to VA with the loan package which indicates:

- the percentage to be used to calculate the tax credit, and
- the amount of the certified indebtedness. The certified indebtedness can be comprised of a loan incurred by the veteran to acquire a principal residence or a qualified home improvement or rehabilitation loan.

If the percentage on the MCC is more than 20 percent, there is an annual limit on the tax credit equal to the lesser of $2,000 or the borrower's maximum tax liability. Calculate the tax credit by applying the specified percentage to the interest paid on the certified indebtedness. Then, apply the annual limit.

Example: The MCC shows a 30-percent rate and $100,000 certified indebtedness. The borrower will pay approximately $8,000 in annual mortgage interest. Borrower's estimated total Federal income tax liability is $9,000. Calculate the tax credit as follows:

- 30 percent of $8,000 = $2,400
- Apply the annual $2,000 limit
- The tax credit will be $2,000
- Use $167 (one-twelfth of $2,000) in the monthly analysis

Note: If the mortgage on which the borrower pays interest is greater than the amount of certified indebtedness, limit the interest used in the tax credit calculation to that portion attributable to the certified indebtedness.

4. Assets

Change date

April 10, 2009, Change 10

- This section has been updated to correct hyperlinks and make minor grammatical edits.

a. Amount of Cash Required

The applicant or spouse must have sufficient cash to cover:

- any closing costs or points which are the applicant's responsibility and are not financed in the loan,
- the downpayment, if a GPM, and
- the difference between the sales price and the loan amount, if the sales price exceeds the reasonable value established by VA.

VA does **not** require the applicant to have additional cash to cover a certain number of mortgage payments, unplanned expenses, or other contingencies.

However, the applicant's ability to accumulate liquid assets and the current availability of liquid assets for unplanned expenses should be considered in the overall credit analysis.

b. Verification Requirement

Verify all liquid assets owned by the applicant or spouse to the extent they are needed to close the loan. In addition, verify any liquid assets that may have a bearing on the overall credit analysis; that is, significant assets.

- Use VA Form 26-8497a, Request for Verification of Deposit, as appropriate, **OR**
- original or certified true copies of the applicant's last two bank statements, **OR**
- the borrower's bank statements available to them by Internet or Faxed from the depository directly to the lender. In cases where the lending institution uses Internet based verifications, ensure the URL appears on the document.

Verifications must be no more than 120 days old (180 days for new construction).

For automatically closed loans, this means the date of the deposit verification is within 120 days of the date the note is signed (180 days for new construction).

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4. Assets, Continued

b. Verification Requirement (continued)

For prior approval loans, this means the date of the deposit verification is within 120 days of the date the application is received by VA (180 days for new construction).

c. Pending Sale of Real Estate

In some cases, the determination that the income and/or assets of a veteran are sufficient to qualify for the loan depends upon the consummation of the sale of presently owned real property.

Sales proceeds may be necessary to make a downpayment or pay closing costs on the VA loan.

In addition, the lender may want to consider the amount of equity the applicant has accumulated in the property and the extent to which that equity is attributable to the applicant's investment rather than the housing market, in evaluating the applicant's ability to manage assets.

The lender may consider any downpayment or costs on the VA loan as provided for by the sale of the property if available information provides a reasonable basis for concluding the equity to be realized from the sale will be sufficient for this purpose.

References:
- See section 4 of chapter 5 for prior approval loans which depend upon the sale of property for the borrower to qualify.
- See section 6 of chapter 5 for required loan closing documents.

5. Debts and Obligations

Change Date

April 10, 2009, Change 10
- This section has been updated to correct hyperlinks and make minor grammatical edits.

a. Verification

Significant debts and obligations of the applicant must be verified and rated.

Obtain a credit report.

Reference: See section 7 of this chapter for details on the type of credit report required.

For obligations not included on the credit report which are revealed on the application or through other means, the lender must obtain a verification of deposit showing the obligation or other written verification directly from the creditor. The lender must also separately verify accounts listed as "will rate by mail only" or "need written authorization."

When a pay stub or LES statement indicates an allotment, the lender must investigate the nature of the allotment to determine whether the allotment is related to a debt.

For obligations that have not been rated on the credit report or elsewhere, obtain the verification and rating directly from the creditor. Include a written explanation for any obligation that is not rated.

Resolve all discrepancies. If the credit report or deposit verification reveals significant debts or obligations which were not divulged by the applicant:

- obtain clarification as to the status of such debts from the applicant, then
- verify any remaining discrepancies with the creditor.

Continued on next page

5. Debts and Obligations, Continued

a. Verification (continued)

Credit reports and verifications must be no more than 120 days old (180 days for new construction).

For automatically closed loans, this means the date of the credit report or verification is within 120 days of the date the note is signed (180 days for new construction).

For prior approval loans, this means the date of the credit report or verification is within 120 days of the date the application is received by VA (180 days for new construction).

ECOA prohibits requests for, or consideration of, credit information on a spouse who will not be contractually obligated on the loan except:

- if the applicant is relying on alimony, child support, or maintenance payments from the spouse (or former spouse), or
- in community property states.
  - -If the property is located in a community property state, VA requires consideration of the spouse's credit information (whether or not the spouse will be personally liable on the note and whether or not the applicant and spouse choose to have the spouse's income considered).

b. Verification of Alimony and Child Support Obligations

The payment amount on any alimony and/or child support obligation of the applicant **must** be verified.

Do **not** request documentation of an applicant's divorce unless it is necessary to verify the amount of any alimony or child support liability indicated by the applicant. If, however, in the routine course of processing the loan, the lender encounters direct evidence (such as, in the credit report) that a child support or alimony obligation exists, make any inquiries necessary to resolve discrepancies and obtain the appropriate verification.

Continued on next page

5. Debts and Obligations, Continued

c. Analysis of Debts and Obligations

Deduct significant debts and obligations from total effective income when determining ability to meet the mortgage payments. Significant debts and obligations include:

- debts and obligations with a remaining term of 10 months or more; that is, long-term obligations, and
- accounts with a term less than 10 months that require payments so large as to cause a severe impact on the family's resources for any period of time.

Example: Monthly payments of $300 on an auto loan with a remaining balance of $1,500, even though it should be paid out in 5 months, would be considered significant. The payment amount is so large as to cause a severe impact on the family's resources during the first, most critical, months of the home loan.

Determine whether debts and obligations which do **not** fit the description of "significant" should be given any weight in the analysis. They may have an impact on the applicant's ability to provide for family living expenses.

If a married veteran wants to obtain the loan in his or her name only, the veteran may do so without regard to the spouse's debts and obligations in a non-community property state. However, in community property states, the spouse's debts and obligations must be considered even if the veteran wishes to obtain the loan in his or her name only.

Debts assigned to an ex-spouse by a divorce decree will not generally be charged against a veteran-borrower. This includes debts that are now delinquent.

Continued on next page

5. Debts and Obligations, Continued

d. Applicant as Co-obligor on Another's Loan

The applicant may have a contingent liability based on co-signing a loan. If:

- there is evidence that the loan payments are being made by someone else, and
- there is no reason to believe that the applicant will have to participate in repayment of the loan, then
- the lender may exclude the loan payments from the monthly obligations factored into the net effective income calculation in the loan analysis.

e. Pending Sale of Real Estate

In some cases, the determination that the income and/or assets of a veteran are sufficient to qualify for the loan depends upon the consummation of the sale of presently owned real property. Sales proceeds may be necessary to:

- clear the outstanding mortgage(s) against the property,
- pay off outstanding consumer obligations, and/or
- make a downpayment or pay closing costs on the VA loan.

Alternatively, the veteran may intend to sell the property with the buyer assuming the outstanding mortgage obligation.

The lender may disregard the payments on the outstanding mortgage(s) and any consumer obligations which the veteran intends to clear if available information provides a reasonable basis for concluding the equity to be realized from the sale will be sufficient for this purpose.

References:
See section 4 of chapter 5 for prior approval loans dependent upon the sale of property for the borrower to qualify.

See section 6 of chapter 5 for required loan closing documents.

Continued on next page

5. Debts and Obligations, Continued

f. Secondary Borrowing

If the applicant plans to obtain a second mortgage simultaneously with the VA-guaranteed loan include the second mortgage payment as a significant debt.

Reference: See section 4 of chapter 9 for VA limitations on secondary borrowing.

From an underwriting standpoint, the veteran must **not** be placed in a substantially worse position than if the entire amount borrowed had been guaranteed by VA.

g. Deferred Student Loan Payments

If student loan repayments are scheduled to begin within 12 months of the date of VA loan closing, lenders should consider the anticipated monthly obligation in the loan analysis. If the borrower is able to provide evidence that the debt may be deferred for a period outside that timeframe, the debt need not be considered in the analysis.

h. Loans Secured By Deposited Funds

Certain types of loans secured against deposited funds (signature loans, cash value life insurance policies, 401K loans, etc…) in which repayment may be obtained through extinguishing the asset, do not require repayment consideration for loan qualification.

Note: Assets securing these loans may not be included as an asset in the loan analysis.

6. Required Search for and Treatment of Debts Owed to the Federal Government

Change Date

April 10, 2009, Change 10

- Subsection d has been updated to note the elimination of the telephone method of accessing CAIVRS.
- This section has been updated to correct hyperlinks and make minor grammatical edits.

a. The Search Requirement

There are two separate procedures the lender must follow. Both should be initiated immediately upon receipt of a loan application to avoid delays in closing the loan.

(1) Ask the veteran and any veteran co-obligors (including spouse if a veteran) if he or she:

- is receiving VA disability benefits,
- would be entitled to receive VA disability benefits, but for the receipt of retired pay,
- has received VA disability benefits in the past, or
- is an unmarried surviving spouse of a veteran who died on active duty or as a result of a service-connected disability.

If the veteran falls under one of the above categories, follow the procedures discussed under subsection b "Debt Related to VA Benefits" of this section.

(2) For all applicants and co-obligors (veteran or nonveteran) on all VA loans including IRRRLs, perform a CAIVRS inquiry.

Reference: See "CAIVRS Procedures" in this section.

Continued on next page

6. Required Search for and Treatment of Debts Owed to the Federal Government, Continued

b. Debt Related to VA Benefits

Before processing a loan involving certain veterans, as described in section a (1) "The Search Requirement," the lender must submit VA Form 26-8937, Verification of VA Benefits, to the VA office where the loan application and/or closed loan package will be sent. VA will complete and return the form to the lender.

The loan cannot be submitted for prior approval or approved under the automatic procedure until the lender obtains the completed form from VA. The lender must maintain the completed form with the loan package.

If the form indicates that the applicant receives a nonservice-connected pension or has been rated incompetent by VA, the loan cannot be closed automatically. Submit the loan for prior approval.

If the form indicates that the applicant has any of the following:

- an outstanding indebtedness of overpaid education, compensation, or pension benefits,
- an education or direct home loan in default,
- an outstanding indebtedness resulting from payment of a claim on a prior guaranteed home loan,
- a repayment plan for any of these debts that is not current, then one of the following must accompany the loan package:
  - evidence of payment in full of the debt, or
  - evidence of a current repayment plan acceptable to VA and evidence that the veteran executed a promissory note for the entire debt balance.
  -

Note: No promissory note is required in cases referred to the Department of Justice, Government Accountability Office, or VA Regional Counsel for judicial enforcement. In such cases, VA will obtain information on the applicant's debt status from these parties and relay pertinent information to the lender.

Continued on next page

6. Required Search for and Treatment of Debts Owed to the Federal Government, Continued

b. Debt Related to VA Benefits (continued)

VA may find a repayment plan acceptable if:

- the veteran has been satisfactorily making payments on a repayment plan in effect prior to the lender's inquiry,
- the veteran's overall credit history and anticipated financial capacity after the proposed loan is made indicate a reasonable likelihood that the repayment plan will be honored and the outstanding amount of indebtedness is not so large that it would prevent payment in full, within a reasonable period (approximately 1 year), or
- the case involves unusually meritorious circumstances.

Example:
Consideration would be given to a veteran with an outstanding credit history and adequate income whose debt balance is too large to be reasonably paid out in less than 18 months to 2 years.

VA will offer special consideration to a veteran's claim that he or she was not previously aware of an overpayment of benefits.

c. What is CAIVRS?

CAIVRS is a Department of Housing and Urban Development (HUD) maintained computer information system which enables participating lenders to learn when an applicant has previously defaulted on a federally-assisted loan. The system's interactive voice response function provides instant credit information.

The database includes default information from the Department of Agriculture, Department of Education, Department of Justice, HUD, Small Business Administration, Federal Deposit Insurance Corporation, and VA.

The VA default information included in the database relates to:

- overpayments on education cases,
- overpayments on disability benefits income, and
- claims paid due to home loan foreclosures.

Continued on next page

6. Required Search for and Treatment of Debts Owed to the Federal Government, Continued

d. CAIVRS Procedures

VA assigns an 11-digit VA lender identification number (ID) to each new lender (See section 12 of chapter 1), then automatically forwards the ID number to HUD with a request to grant the lender CAIVRS access. The lender can begin accessing CAIVRS usually between 1 week and 10 business days after receiving its VA ID number assignment.

Lenders must perform a CAIVRS screening on all obligors on the loan (including IRRRL loans). The one exception to this policy is that CAIVRS is **not** required for non-purchasing spouses in community property states.

On October 1, 2008, HUD discontinued all telephone access to CAIVRS. As of that date, lenders must obtain CAIVRS information via the Internet.

Internet Access for Federal Housing Administration (FHA) Approved Lenders
FHA-approved lenders who are currently accessing CAIVRS via telephone and who have FHA Connection User IDs, should request that their FHA Connection Application Coordinator update their FHA Connection profile to include CAIVRS. FHA approved lenders who do **not** have FHA Connection User IDs, should access the FHA connection at https://entp.hud.gov/clas/index.cfm, and select *Registering a New User* to request a User ID and access to CAIVRS.

Internet Access for Non-FHA Participating Lenders
Non-FHA participating lenders who are currently accessing CAIVRS via the telephone should request online access from http://www.hud.gov/offices/hsg/sfh/sys/caivrs/caivrs.cfm, select the *Using CAIVRS* option. Once at the site, select *Registration for Lender User ID* from the main menu and complete all fields. Select *Veterans' Affairs* for the Agency field and enter the first 10 digits of your VA Lender ID. Each non-FHA participating lender must request at least one Application Coordinator ID as well as a Standard User ID for each individual user.

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6. Required Search for and Treatment of Debts Owed to the Federal Government, Continued

d. CAIVRS Procedures (continued)

Please direct questions concerning problems encountered with online registration or access to the HUD Resource Center at 1-800-CALL-FHA (1-800-225-5342).

Once screening is complete, enter the CAIVRS confirmation code on VA Form 26-6393, Loan Analysis, in the space to the right of the "no" block in item 46.

For IRRRLs, enter the code on VA Form 26-8923, IRRRL Worksheet, beside the word "Note" located near the bottom of the form.

e. Applicant Presently Delinquent

Give full consideration to the CAIVRS information, and any subsequent clarifying information provided, in applying VA credit standards.

- Consider the terms of any repayment plan in analyzing monthly debt payments.
- Consider any delinquencies in determining creditworthiness.

CAIVRS information is only for the lender's and applicant's use in processing the loan application. Only those persons having responsibility for screening applicants and/or co-obligors may use CAIVRS. **Any other use is unauthorized**.

Continued on next page

6. Required Search for and Treatment of Debts Owed to the Federal Government, Continued

e. Applicant Presently Delinquent (continued)

If the CAIVRS screening indicates an applicant (or co-obligor) is presently delinquent or has had a foreclosure or a claim paid on a loan made, guaranteed, or insured by a Federal agency, take the following actions:

Step	Action
1	Suspend processing of the loan application.
2	Contact the applicant or co-obligor for information regarding the loan default, foreclosure, or claim. If a previous VA loan is involved, the applicant may call 1-800-827-0648 to make arrangements to repay the debt.
3	Contact the Federal agency that reported the applicant to CAIVRS if further information is needed. Use the phone number provided by CAIVRS (Step 7 in the previous table).

f. Treatment of Federal Debts

An applicant cannot be considered a satisfactory credit risk if he or she is presently delinquent or in default on any debt to the Federal Government until the delinquent account has been brought current or satisfactory arrangements have been made between the applicant and the Federal agency. The refinancing of a delinquent VA loan with an IRRRL satisfies this requirement.

An applicant cannot be considered a satisfactory credit risk if he or she has a judgment lien against his or her property for a debt owed to the Government until the judgment is paid or otherwise satisfied.

7. Credit History

Change Date

April 10, 2009, Change 10
- This section has been updated to make minor grammatical edits.

a. Credit Report Standards

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, the date of the credit report must be within 120 days of the date the note is signed (180 days for new construction).

For prior approval loans, the date of the credit report must be within 120 days of the date the application is received by VA (180 days for new construction).

If an RMCR is Used
The standards applicable to an 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; such as bankruptcies, judgments, law suits, foreclosures and tax liens.
- The RMCR must be an original report, with no erasures, whiteouts, or alterations.
- The report must contain a 24-month employment and residency history.

Continued on next page

7. Credit History, Continued

a. Credit Report Standards (continued)

VA may decline to accept a credit report which does not meet these standards.

VA will notify the lender and the credit reporting agency of how quality standards are not being met. If the problem continues, VA will inform all participating lenders that credit reports from the particular credit reporting agency are unacceptable.

All inquiries made within the last 90 days must be included on the report.

b. Verification and Rating of Debts and Obligations

See section 5 of this chapter for requirements of verification.

c. How to Analyze Credit

The applicant's past repayment practices on obligations are the best indicator of his or her willingness to repay future obligations. Emphasis should be on the applicant's overall payment patterns rather than isolated occurrences of unsatisfactory repayment. Determine whether the applicant (and spouse, if applicable) is a satisfactory credit risk based on a careful analysis of the credit report and other credit data.

Rent and Mortgage Payment History
The applicant's rental history and any outstanding, assumed, or recently retired mortgages must be verified and rated.

Housing expense payment history is often the best indicator of how motivated the applicant is to make timely mortgage payments in the future.

Absence of Credit History
For applicants with no established credit history, base the determination on the applicant's payment record on utilities, rent, automobile insurance, or other expenses that applicant has paid.

Continued on next page

7. Credit History, Continued

c. How to Analyze Credit (continued)

Absence of a credit history is **not** generally considered an adverse factor. It may result when:

- recently discharged veterans have not yet developed a credit history,
- applicants have routinely used cash rather than credit, and/or
- applicants have not used credit since some disruptive credit event such as bankruptcy or debt pro-ration through consumer credit counseling. In these cases, develop evidence of timely payment of noninstallment obligations such as rent and utilities since the disruptive credit event.

Reference: For bankruptcy cases, see "Bankruptcy" in this section.

Accounts in the Spouse's Name
Under ECOA - Upon the applicant's request, the lender must consider any account reported in the name of the applicant's spouse or former spouse that the applicant can demonstrate accurately reflects the applicant's creditworthiness.

Consideration of the Spouse's Credit History
ECOA prohibits requests for, or consideration of, the credit of a spouse who will not be contractually obligated on the loan except:

- if the applicant is relying on alimony, child support, or maintenance payments from the spouse (or former spouse), or
- in community property states.
  - If the property is located in a community property state, VA requires consideration of the spouse's credit (whether or not the spouse will be personally liable on the note and whether or not the applicant and spouse choose to have the spouse's income considered).
  - If a married veteran wants to obtain the loan in his or her name only, the veteran may do so without regard to the spouse's credit only in a non-community property state.

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7. Credit History, Continued

c. How to Analyze Credit (continued)

Adverse Data

Reestablished Credit: In circumstances not involving bankruptcy, satisfactory credit is generally considered to be reestablished after the veteran, or veteran and spouse, have made satisfactory payments for 12 months after the date the last derogatory credit item was satisfied. For example, assume a credit report reveals several unpaid collections, including some which have been outstanding for many years. Once the borrower has satisfied the obligations, and then makes timely payments on subsequent obligations for at least 12 months, satisfactory credit is reestablished.

Collections: Isolated collection accounts do not necessarily have to be paid off as a condition for loan approval. For example, 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 reestablished satisfactory credit (see previous paragraph) in order to be considered a satisfactory credit risk.

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. 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. For unpaid debts or debts that have not been paid timely, pay-off of these debts after the acceptability of applicant's credit is questioned does not alter the unsatisfactory record of payment.

Summary: The above guidance is not meant to address every possible scenario. Lenders should carefully review the complete credit history and use their judgment. For example, if an applicant has numerous unpaid collections – no matter when they were established – it’s not unreasonable to question the borrower’s ability and willingness to honor obligations. If the applicant and/or spouse are determined satisfactory credit risks in spite of derogatory credit information, the loan file should include an explanation from the applicant(s) and the lender’s underwriter of the basis for the determination. If lenders are unsure about a particular situation, they should contact the appropriate VA Regional Loan Center.

Continued on next page

7. Credit History, Continued

d. Consumer Credit Counseling Plan

If a veteran, or veteran and spouse, have 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 veteran, or veteran and spouse, have 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 veteran entered the Consumer Credit Counseling plan before reaching the point of having bad credit.

e. Bankruptcy

The fact that a bankruptcy exists in an applicant's (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
You may disregard a bankruptcy discharged more than 2 years ago.

If the bankruptcy was discharged within the last 1 to 2 years, it is probably **not** possible to determine that the applicant or spouse is a satisfactory credit risk unless both of the following requirements are met:

- the applicant or spouse has obtained consumer items on credit subsequent to the bankruptcy and has satisfactorily made the payments over a continued period, and
- the bankruptcy was caused by circumstances beyond the control of the applicant 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.

Continued on next page

7. Credit History, Continued

e. Bankruptcy (continued)

If the bankruptcy was caused by failure of the business of a self-employed applicant, it may be possible to determine that the applicant is a satisfactory credit risk if

- the applicant obtained a permanent position after the business failed,
- there is no derogatory credit information prior to self-employment,
- there is no derogatory credit information subsequent to the bankruptcy, and
- failure of the business was **not** due to the applicant's misconduct.

If a borrower or spouse has been discharged in bankruptcy within the past 12 months, it will **not** generally be possible to determine that the borrower or spouse is a satisfactory credit risk.

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 applicant has finished making all payments satisfactorily, the lender may conclude that the applicant has reestablished satisfactory credit.

If the applicant 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.

f. Foreclosures

The fact that a home loan foreclosure (or deed-in-lieu of foreclosure) exists in an applicant's (or spouse's) credit history does **not** in itself disqualify the loan.

- Develop complete information on the facts and circumstances of the foreclosure.
- Apply the guidelines provided for bankruptcies filed under the straight liquidation and discharge provisions of the bankruptcy law. See the preceding heading entitled "Bankruptcy."

If the foreclosure was on a VA loan, the applicant may not have full entitlement available for the new loan. Ensure that the applicant's Certificate of Eligibility reflects sufficient entitlement to meet any secondary marketing requirements of the lender.

8. Documentation for Automated Underwriting Cases

Change Date

April 10, 2009, Change 10

- Subsection b has been updated by removing the requirement for a separate certification on Automated Underwriting cases receiving an "Accept" or "Approve."
- This section has been updated to make minor grammatical edits.

a. General

VA has approved Freddie Mac's Loan Prospector, Fannie Mae's Desktop Underwriter, pmiAura System for VA, CLUES (for loans originated by Countrywide), Zippy (for loans originated by Chase), Automated Underwriting Systems (AUS) for use in connection with VA-guaranteed home loans. These systems incorporate VA's credit standards and processing requirements.

Lenders may use certain reduced documentation requirements on cases processed with approved AUS. The level of reduced documentation depends on the risk classification assigned. The systems use slightly different terminology such as Approve or Accept. The tables in this section give a general description of documentation waivers. Please note that the documentation requirements are the same for these cases as for non-AUS cases, except for any differences cited in the tables.

Data Integrity

It is imperative that the data entered into the automated underwriting system be accurately verified. The data utilized by the system must be supported by source documentation obtained by the lender. Inaccurate or unverified data will result in invalidation of the risk classification. Under certain circumstances, it could also result in a finding of material misrepresentation, which could affect the validity of the guaranty.

b. Underwriter's Certification

Because the AUS will be making the determination that the loan satisfies credit and income requirements, cases receiving an "Accept" or "Approve" rating will not require the underwriter's certification on VA Form 26-6393, Loan Analysis (items 49 through 53).

Continued on next page

8. Documentation for Automated Underwriting Cases, Continued

c. Documentation Guidelines For Credit History

Refer to the following table for Documentation guidelines for credit history.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept/Approve**
Types of credit reports used in reconciliation (section 7 of this chapter)	Use any of the following if ≤120 days old: • All in-file reports, • Selected in-file reports, • Merged credit report, or • RMCR.	Same as Refer.
Explanation of discrepancies in reported debt (section 5 of this chapter)	No explanation is required.	Same as Refer.
Rental payment history (section 7 of this chapter)	Provide a 12 month rental history directly from landlord, through information shown on credit report or by cancelled checks.	No verification of rent is required.
Verification of significant nonmortgage debt (section 5 of this chapter)	Obtain direct verification for significant debts not reported on the credit report. ***Note***: Significant means that the debt has a monthly payment exceeding 2 percent of the stable monthly income for all borrowers.	Same as Refer. ***Note***: Perform manual downgrade to Refer if direct verification reveals more than 1 by 30 day late payment in the past 12 months for any of the omitted debts.

Continued on next page

8. Documentation for Automated Underwriting Cases,
Continued

c. Documentation Guidelines For Credit History (continued)

Subject and Reference	**Documentation Classification**	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept/Approve**
Mortgage payment history (section 7 of this chapter)	Obtain direct verification when ratings are not available on mortgages that are any of the following: • outstanding, • assumed, or • recently retired. A written explanation of mortgage payment history is required for borrowers with more than 1 by 30 day late payment for all mortgages for the past 12 months.	Perform manual downgrade to Refer for any mortgage debt with more than 1 by 30 day late payment in the past 12 months.
Account balances (section 7 of this chapter)	If a mortgage or other significant debt is listed on the credit report as past due and was last updated ≥90 days, verify current status of past due debt.	Same as Refer, however if rating is currently ≥90 days past due, manually downgrade to **REFER**.
Derogatory credit information (section 7 of this chapter)	Obtain explanation for derogatory credit. Explain assessment of creditworthiness on VA Form 26-6393, Loan Analysis.	No determination of ratios or credit worthiness is required.
Alimony and/or child support payments (section 2 of this chapter)	Provide the following: • proof of deposits on bank statements for 3 months, and • front page and details of support payments from the divorce decree, indicating evidence of at least 3 years continuance.	Same as Refer.

Continued on next page

8. Documentation for Automated Underwriting Cases,
Continued

d. Documentation Guidelines for Borrowers-Not Self Employed

Refer to the following table for documentation guidelines for employment/income for borrowers who are not self-employed.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept/Approve**
Employment gaps (section 2 of this chapter)	No explanation for employment gaps is required if the gaps are <30 days.	No explanation for employment gaps is required if gaps are <60 days.
Verifying current employment for borrowers who are not self-employed (section 2 of this chapter)	Document telephone contact verifying borrower's current employer. Use pay stubs covering at least 1 full month of employment and contains the following: • year-to-date (YTD) information, • bonus information, and • overtime information.	Same as Refer.

Continued on next page

8. Documentation for Automated Underwriting Cases,
Continued

d. Documentation Guidelines for Borrowers-Not Self Employed (continued)

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept/Approve**
Verifying previous employment (section 2 of this chapter)	Use a VOE or any of the following, covering the 2-year period prior to closing: • W-2 Forms, or • Income information obtained from the IRS via one of the following forms: - Form 8821, Tax Information Authorization, (or alternate form acceptable to the IRS that collects comparable information) or - Form 4506, Request for Copy of Tax Return, (or alternate form acceptable to the IRS that collects comparable information).	No VOE is required if the borrower has been with the same employer for 1 year and W-2 Forms for 1 previous year have been collected. No W-2 Forms are required for a borrower on active duty. No W-2 Forms are required if all of the following are met: - Borrower with same employer ≥2 years - Employer phone contact verifies the length of employment and current status (still employed) - Borrower not self-employed or commissioned - Bonus, overtime, or secondary income not needed to qualify - Stable monthly income to be determined by using current base pay only (rather than total earnings) - Borrower signs one of the following for the previous 2 tax years: - Form 8821, and - Form 4506.

Continued on next page

8. Documentation for Automated Underwriting Cases,
Continued

e. Documentation Guidelines for Borrowers-Self Employed

Refer to the following table for documentation guidelines for employment/income for borrowers who are self-employed.

Subject and Reference	**Documentation Classification**	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept/Approve**
Individual tax returns for self-employed borrowers (section 2 of this chapter)	Provide one of the following, with all line items captured: • signed copies of individual tax returns for the most recent 2-year period, or • individual income information obtained from the IRS via one of the following forms: - Form 8821 (or an alternate form acceptable to the IRS that collects comparable information) or - Form 4506 (or an alternate form acceptable to the IRS that collects comparable information).	Same as Refer.
Balance sheets and profit and loss statements for self-employed borrowers (section 2 of this chapter)	No balance sheet or YTD Profit and Loss (YTD P&L) is required if origination date is $\leq$ 7 months from the business' fiscal year end (for which tax returns or information from the IRS via Form 8821 or Form 4506 were provided).	No balance sheet or YTD P&L is required.

Continued on next page

8. Documentation for Automated Underwriting Cases, Continued

e. Documentation Guidelines for Borrowers-Self Employed (continued)

<table>
<tr><th rowspan="2">Subject and Reference</th><th colspan="2">Documentation Classification</th></tr>
<tr><th>Documentation Guidelines and Reductions for Refer</th><th>Additional Documentation Reductions for Accept/Approve</th></tr>
<tr><td>Business tax returns for self-employed borrowers (section 2 of this chapter)</td><td>Provide one of the following, with all line items captured:
• Signed copies of business tax returns for the most recent 2- year period.
• Business income information obtained from the IRS via one of the following forms:
- Form 8821 (or an alternate form acceptable to the IRS that collects comparable information) or
- Form 4506 (or an alternate form acceptable to the IRS that collects comparable information).</td><td>No business tax returns are required if all of the following conditions are met:
• Borrower proves ownership of the business for at least the past 5 years.
• Individual tax returns reflect consistent income for the past 2 years.
• Funds for downpayment or closing costs are not from the business.</td></tr>
</table>

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8. Documentation for Automated Underwriting Cases,
Continued

f. Documentation Guidelines for Assets

Refer to the following table for documentation guidelines for assets.

Subject and Reference	Documentation Classification	
	Documentation Guidelines and Reductions for Refer	**Additional Documentation Reductions for Accept/Approve**
Verify closing costs (section 4 subsection a of this chapter)	Verify veteran's source of funds for payment of any difference between sales price and loan amount plus closing costs, if the sales price exceeds reasonable value established by the Notice of Value (NOV).	No verification of veteran's source of funds is required if closing costs plus the difference between the sales price of the property and the base loan amount is <4 percent of the lesser of the following: • sales price, or • reasonable value established by an NOV.
Verify assets to close in the applicant's name (section 4 of this chapter)	Provide original bank statements or certified true copies covering the most recent 2-month period in lieu of a Verification of Deposit (VOD).	Provide original bank statements or certified true copies covering most recent 1-month period in lieu of a VOD.

9. How to Complete VA Form 26-6393, Loan Analysis

Change Date

April 10, 2009, Change 10
- This section has been updated to make minor grammatical edits.

a. General

In order to properly enter information on VA Form 26-6393, Loan Analysis, the underwriter must understand and apply the guidelines provided in the preceding sections of this chapter.

Self-explanatory items are **not** discussed in this section.

b. Estimated Monthly Shelter Expenses

Special instructions are listed in the following table.

Item	Special Instructions
16	If taxes are expected to increase, use the increased amount.
17	Include the flood insurance premium for properties located in special flood hazard areas.
18	If special assessments are anticipated, use the anticipated amount.
19	Calculate maintenance and utility costs using 14¢ per square foot. ***Example***: A 1500 square foot home would have a combined maintenance and utility cost of $210 (1500sq X .14).
20	For condominiums or houses in a Planned Unit Development (PUD), include the monthly amount of maintenance assessment payable to the homeowner's association. If the assessment is less than the maximum provided in the covenants or master deed and it appears likely that the assessment will be insufficient for operation of the condominium or PUD, include the maximum amount the veteran could be charged.

Continued on next page

9. How to Complete VA Form 26-6393, Loan Analysis,
Continued

c. Debts and Obligations

List all known debts and obligations of the applicant and spouse including any alimony and/or child support payments.

Place a check mark in the (3) column next to any "significant" debt or obligation. See the topic "Analysis of Debts and Obligations" in section 5 of this chapter, for an explanation of "significant."

Job Related Expense
Include any costs for child care, significant commuting costs, and any other direct or incidental costs associated with the applicant's (or spouse's) employment. Check this item if total job-related expenses are significant.

d. Item 33, Federal Income Tax

Enter the applicant's estimated monthly Federal income tax. If the applicant has a MCC, reduce the Federal income tax by the estimated tax credit.

Reference: See the topic "Income Tax Credits from Mortgage Credit Certificates" in section 3 of this chapter.

e. Item 44, Balance Available for Family Support

Enter the appropriate residual income amount from the following tables in the "guideline" box. Residual income is the amount of net income remaining (after deduction of debts and obligations and monthly shelter expenses) to cover family living expenses such as food, health care, clothing, and gasoline.

The numbers are based on data supplied in the Consumer Expenditures Survey (CES) published by the Department of Labor's Bureau of Labor Statistics. They vary according to loan size, family size, and region of the country.

Special Instructions for Using Tables
Count **all** members of the household (without regard to the nature of the relationship) when determining "family size," including:

- an applicant's spouse who is **not** joining in title or on the note, and
- any other individuals who depend on the applicant for support. For example, children from a spouse's prior marriage who are not the applicant's legal dependents.

Continued on next page

9. How to Complete VA Form 26-6393, Loan Analysis,
Continued

e. Item 44, Balance Available for Family Support (continued)

Special Instructions for Using Tables *(continued)*
Exception: The lender may omit any individuals from "family size" who are fully supported from a source of verified income which, for whatever reason, is **not** included in effective income in the loan analysis. For example:

- a spouse not obligated on the note who has stable and reliable income sufficient to support his or her living expenses, or
- a child for whom sufficient foster care payments or child support is received regularly.

Reduce the residual income figure (from the following tables) by a minimum of five percent if:

- the applicant or spouse is an active-duty or retired serviceperson, and
- there is a clear indication that he or she will continue to receive the benefits resulting from use of military-based facilities located near the property.

Use five percent unless the VA office of jurisdiction has established a higher percentage, in which case, apply the specified percentage for that jurisdiction.

A key to the geographic regions is listed in the following tables.

Table of Residual Incomes by Region For loan amounts of $79,999 and below				
Family Size	**Northeast**	**Midwest**	**South**	**West**
1	$390	$382	$382	$425
2	$654	$641	$641	$713
3	$788	$772	$772	$859
4	$888	$868	$868	$967
5	$921	$902	$902	$1,004
over 5	Add $75 for each additional member up to a family of seven.			

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9. How to Complete VA Form 26-6393, Loan Analysis,
Continued

e. Item 44, Balance Available for Family Support (continued)

Table of Residual Incomes by Region
For loan amounts of $80,000 and above

Family Size	Northeast	Midwest	South	West
1	$450	$441	$441	$491
2	$755	$738	$738	$823
3	$909	$889	$889	$990
4	$1,025	$1,003	$1,003	$1,117
5	$1062	$1,039	$1,039	$1,158
over 5	Add $80 for each additional member up to a family of seven			

Key to Geographic Regions Used in the Preceding Tables

Northeast	Connecticut Maine Massachusetts	New Hampshire New Jersey New York	Pennsylvania Rhode Island Vermont
Midwest	Illinois Indiana Iowa Kansas	Michigan Minnesota Missouri Nebraska	North Dakota Ohio South Dakota Wisconsin
South	Alabama Arkansas Delaware District of Columbia Florida Georgia	Kentucky Louisiana Maryland Mississippi North Carolina Oklahoma	Puerto Rico South Carolina Tennessee Texas Virginia West Virginia
West	Alaska Arizona California Colorado	Hawaii Idaho Montana Nevada	New Mexico Oregon Utah Washington Wyoming

Continued on next page

9. How to Complete VA Form 26-6393, Loan Analysis,
Continued

f. Item 45, Debt-to-Income Ratio

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, and other debt) to gross monthly income.

Add: Items 15 + 16 + 17 + 18 +20 +40 = Debt

Add: Items 31 + 38* = Income

Divide: Debt ÷ Income = Debt-to-Income Ratio

Round: To the nearest two digits

The "Debt-to-Income Ratio" heading in section 10 of this chapter contains special procedures to apply if the ratio exceeds 41 percent.

*Tax-free income may be "grossed up" for purposes of calculating the debt-to-income ratio only (**not** residual income). This is a tool that may be used to lower the debt ratio for veterans who clearly qualify for the loan. "Grossing up" involves adjusting the income upward to a pre-tax or gross income amount which, after deducting state and Federal income taxes, equals the tax-exempt income. Use current income tax withholding tables to determine an amount which can be prudently employed to adjust the borrower's actual income. Do not add non-taxable income to taxable income before "grossing up."

Tax-free income includes certain military allowances, child support payments, workers' compensation benefits, disability retirement payments, and certain types of public assistance payments. Verify that the income is indeed tax-free before "grossing up."

If "grossing up" is used, indicate such and provide the "grossed up" ratio in item 47, "Remarks."

g. Item 46, Past Credit Record

Indicate whether the applicant (and spouse, if applicable) is a satisfactory or unsatisfactory credit risk based on a complete analysis of credit data.

10. How to Analyze the Information on VA Form 26-6393

Change Date

April 10, 2009, Change 10

- This section has been updated to make minor grammatical edits.

a. Residual Income

VA's minimum residual incomes (balance available for family support) are a guide. They should not automatically trigger approval or rejection of a loan. Instead, consider residual income in conjunction with all other credit factors.

An obviously inadequate residual income alone can be a basis for disapproving a loan.

If residual income is marginal, look to other indicators such as the applicant's credit history, and in particular, whether and how the applicant has previously handled similar housing expense.

Consider whether the purchase price of the property may affect family expense levels. For example, a family purchasing in a higher priced neighborhood may feel a need to incur higher-than-average expenses to support a lifestyle comparable to that in their environment, whereas a substantially lower priced home purchase may not compel such expenditures.

Also consider the ages of the applicant's dependents in determining the adequacy of residual income.

Continued on next page

10. How to Analyze the Information on VA Form 26-6393, Continued

b. Debt-to-Income Ratio

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, and so on) to gross monthly income. It is a guide and, as an underwriting factor, it is secondary to the residual income. It should not automatically trigger approval or rejection of a loan. Instead, consider the ratio in conjunction with all other credit factors.

A ratio greater than 41 percent requires close scrutiny unless:

- the ratio is greater than 41 percent solely due to the existence of tax-free income (Put notation regarding the tax-free income in the loan file or calculate an adjusted, smaller ratio based on "grossing up" of the tax-free income.), or
- residual income exceeds the guideline by at least 20 percent.

Loans Closed Automatically with Ratio Greater than 41 percent
Include a statement justifying the reasons for approval, signed by the underwriter's supervisor, unless residual income exceeds the guideline by at least 20 percent. The statement must:

- not be perfunctory, or
- list the compensating factors justifying approval of the loan.

c. Credit History

A poor credit history alone is a basis for disapproving a loan.

If credit history is marginal, look to other indicators such as residual income.

Continued on next page

10. How to Analyze the Information on VA Form 26-6393, Continued

d. Compensating Factors

Compensating factors may affect the loan decision. These factors are especially important when reviewing loans which are marginal with respect to residual income or debt-to-income ratio. They cannot be used to compensate for unsatisfactory credit.

Valid compensating factors should represent unusual strengths rather than mere satisfaction of basic program requirements. For example, the fact that an applicant has sufficient assets for closing purposes, or meets the residual income guideline, is not a compensating factor.

Valid compensating factors should logically be able to compensate (to some extent) for the identified weakness in the loan. For example, significant liquid assets may compensate for a residual income shortfall whereas long-term employment would not.

Compensating factors include, but are not limited to the following:

- excellent credit history,
- conservative use of consumer credit,
- minimal consumer debt,
- long-term employment,
- significant liquid assets,
- sizable downpayment,
- the existence of equity in refinancing loans,
- little or no increase in shelter expense,
- military benefits,
- satisfactory homeownership experience,
- high residual income,
- low debt-to-income ratio,
- tax credits for child care, and
- tax benefits of home ownership.

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10. How to Analyze the Information on VA Form 26-6393, Continued

e. Compare What Shelter Expenses will be to What Applicant Pays Now

Closely scrutinize a case in which the applicant will be paying significantly higher shelter expenses than he or she currently pays. Consider the:

- ability of the applicant and spouse to accumulate liquid assets; such as cash and bonds, and
- amount of debts incurred while paying a lesser amount for shelter.

If an application shows little or no capital reserves and excessive obligations, it may not be reasonable to conclude that a substantial increase in shelter expenses can be absorbed.

11. Examples of Underwriting Deficiencies

Change Date

April 10, 2009, Change 10
- This section has been updated to make minor grammatical edits.

a. Purpose

Because of the high loan-to-value ratios of VA-guaranteed loans, it is critical that underwriters use sound judgment. The underwriting deficiencies listed in this section represent a sample of actual deficiencies found on VA loans that went into default. The deficiencies were of such significance that many of the loans should **not** have been made.

b. Inadequate Development of Credit Information

Deficiencies included:

- failing to compare documented information with the applicant's initial application,
- failing to question and investigate obvious discrepancies
  - in the number of dependents or household size, and
  - between actual year-to-date average monthly earnings and the income claimed on the loan application,
- failing to question multiple Social Security numbers for an applicant,
- failing to determine future plans of an active-duty serviceperson whose separation from service is imminent, and
- accepting an explanation for a bad credit history without documenting the circumstances alleged to have caused the credit problem, judgment, or bankruptcy.

c. Missing Documentation

Deficiencies included failure:

- to inquire about and document the payment history on previous home loans, including prior VA loans, and
- to obtain documentation of employment history during the previous 2 years.

Continued on next page

11. Examples of Underwriting Deficiencies, Continued

d. Verification and Procedural Errors

Deficiencies included:

- requiring the veteran to sign partially completed or blank forms,
- permitting income or asset deposit information to be hand carried by the applicant, real estate/sales agent, or a party other than the lender's specifically-designated employee,
- addressing verification forms to an individual chosen by the applicant rather than to the employer's personnel or payroll department, and
- obtaining multiple/revised credit reports without validating the need for the subsequent reports.

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e. Income Analysis Errors

Deficiencies included:

- showing that an applicant is a salaried employee when, in fact, the applicant works solely on a commission basis, is a contract employee, or is actually self-employed,
- failing to use net profit or net income from Schedule C of Internal Revenue Service Form 1040 rather than the gross income of an applicant who is self-employed
- using short-term, temporary, or sporadic income to qualify an applicant for a loan, and
- qualifying a marginal applicant for a loan by using a buydown or GPM without establishing that the applicant's income will keep pace with the scheduled increase in mortgage payments. This is especially important in times of low inflation and stagnant or declining real estate markets.

Examples of unreliable income sources include:

- overtime pay in an industry or area that is experiencing an economic slowdown or decline,
- income from a second job even though the applicant does not have a record of steadily working two jobs,
- rental income even though the applicant does not have verified experience as a landlord, and
- poorly documented income from self-employment.

Continued on next page

11. Examples of Underwriting Deficiencies, Continued

f. Other Analysis Errors

Deficiencies included:

- Filing to consider
  - changes in marital status or household size after application and prior to closing, and
  - pay statements showing deductions to creditors that are not shown on the application, credit reports, or deposit verifications.
- Approving a loan solely on the basis of an emotional appeal from the applicant or spouse, the sales agent, seller, or other interested party.

Note: A decision or an inclination to reject a loan application should **not** be changed unless there is new and compelling information available to justify approving the loan.

- Approving high debt-to-income ratio loans with few or no valid compensating factors.
- Using gift letters to offset past due obligations, pay off debts, and so on, without consideration of the credit risk implications of the past due obligations.
- Ignoring debts, judgments, bankruptcies, alimony or child support obligations because they don't appear on the credit report.
- Failing to reconcile a large increase in shelter expense with an undemonstrated ability to accumulate cash assets.