The purpose of this presentation is to give viewers a basic overview of the credit requirements for the Section 502 and 504 Direct Loan Programs. While this recorded webinar is targeted to Rural Development (RD or Agency) staff, others (such as loan application packagers) may find the information useful.

Creditworthiness

- Evaluating an applicant's creditworthiness requires a determination of the applicant's ability and willingness to meet their debt obligations
  - Ability: Income availability and reliability
  - Willingness: Credit payment history

- Exhibit 4-4, Indicators of Unacceptable Credit is used to evaluate the applicant's credit history.

To qualify, an applicant must meet the program's income, credit, repayment, and other eligibility requirements. When considering creditworthiness, the Agency considers both the applicant's ability and willingness to meet their debt obligations.

Ability has to do with the applicant's available, reliable income and considers whether the applicant has adequate income to repay their debt obligations from stable income source(s).

Willingness on the other hand means that the applicant not only has funds available but is willing to use those funds to pay their creditors. In other words, you could be a millionaire with more than enough ability to pay your bills, but if you choose not to pay those to whom you owe debts, then you don't show a willingness to do so.

Both components: ABILITY and WILLINGNESS to pay are critical to the credit analysis.

The indicators of unacceptable credit described in Exhibit 4-4 can be used to evaluate the applicants credit history.

Types of Credit Reports

- Tri-Merge Credit Report (TMCR)
- Infile credit report
- Free credit report:
  Call: 1-877-322-8228 or
  Visit: https://www.annualcreditreport.com

There are three types of credit reports mentioned in the program's handbook (known as Handbook-1-3550).

When a complete application is received, the Agency orders a Tri-Merge Credit Report or TMCR for each applicant through the loan origination system. The TMCR contains information from the three major repositories, is used to determine if the applicant's credit history and score meets the program guidelines for streamlined processing, and is used to render an official eligibility decision.

An infile credit report is a single repository report ordered by the Agency at no cost to the individual. Infile credit reports are primarily used for unsecured Section 504 repair loans less than $7,500.

As outlined in Attachment 3-J, Checklist of Items to Accompany the Uniform Residential Loan Application, an applicant must provide (among other items) a nonrefundable credit report fee for the TMCR and a written explanation for any late payments, collections, judgments, or other derogatory items in their credit history. Attachment 3-J informs the applicant that if they are unsure what their credit history looks like, they can obtain a free credit report by calling 1-877-322-8228 or by visiting https://www.annualcreditreport.com. By law, individuals are entitled to receive one free credit file disclosure weekly from each of the nationwide consumer credit reporting companies – Equifax, Experian, and TransUnion.

Whose Credit is Reviewed?

- **<u>FOR ALL STATES</u>**:
  All note signers (applicant, co-applicant and co-signer if present)
- **<u>FOR COMMUNITY PROPERTY STATES ONLY</u>:**
  Non-purchasing spouse (NPS)
  - NPS's obligations are considered in the applicant's Total Debt
  - The applicant's NPS must provide a copy of the credit report
  - NPS's credit history is never considered a reason to deny a loan
  - Judgements must be paid in full unless an exception is granted by the Loan Approval Official

For all states, a credit report is obtained on anyone who will sign the promissory note. Note signers include the applicant, co-applicants, and a co-signer if present to supplement to the applicant's repayment ability.

If you are in a community property state, when one spouse is a note signer, but the other is not, the spouse who will not be a note signer is called a Non-Purchasing Spouse or NPS. The non-purchasing spouse's obligations must be considered in the total debt ratio to determine the applicant's purchasing capacity, unless excluded by State law.

The applicant must provide the Agency with a copy of their non-purchasing spouse's credit report. The NPS's credit report (or reports) must contain information from Equifax, Experian, and TransUnion and can come from a source that was free or paid for. The report(s) provided cannot be more than nine months old when the underwriting decision is to be made or at the time of loan closing. While the NPS's debts are evaluated and included in the applicant's Total Debt ratio, the non-purchasing spouse's credit history will not be a reason to deny a loan since they are not party to the note. Any judgment against the NPS must be paid in full unless an exception is granted by the Loan Approval Official. Community property states include: **Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Puerto Rico allows property to be owned as community property as do several Indian jurisdictions. Alaska is an opt out community property state.**

While the NPS's debts are evaluated and included in the applicant's Total Debt ratio, the non-purchasing spouse's credit history will not be a basis on which to deny a loan since they are not the applicant. Any judgment against the NPS must be paid in full unless an exception is granted by the Loan Approval Official.

If the non-purchasing spouse is not a citizen or emancipated minor, and obtaining a credit report isn't feasible, the Housing Program Director may waive this request on a case-by-case basis.

If a non-purchasing spouse in a community property state is unwilling or unable to provide a credit report, the application will not be considered complete.

Credit History Review

- Credit decisions are based on the TMCR ordered by Rural Development (RD)
- Credit reports are used to determine if an applicant has a **recent** history of consistently and dependably making payments

Regardless of whether the Section 502 application is received directly by RD, or from a loan application packager, Rural Development will always order a Tri-Merge Credit Report (TMCR) via its loan origination system to evaluate the applicant's credit.

The credit report is used to determine if the applicant has a recent history of consistently and dependably making payments. While three years of history is evaluated, preference is given to the most recent 24 months as it is most reflective of the applicant's current circumstances. In the following slides we will review how credit scores are evaluated, how an applicant can qualify for a streamlined credit analysis, and what steps are taken if an applicant has adverse credit.

Reviewing the Credit Report

Review

- Form RD 410-4 vs Credit Report
- Ask applicant to clarify discrepancies/write letter of explanation
- Ask about recent inquiries; confirm whether opened
- Is applicant responsible or only an authorized user?

Verify

- If score under 640 for 502 loans (620 for 504 loans), obtain
  - Verification of rent/mortgage
- If traditional credit is not used, or there are < 2 scores, consider nontraditional / alternative credit

Explain

- Review for Indicators of Unacceptable Credit handling outlined in Exhibit 4-4, if applicable
- If score below 640 (502 loans) or below 620 (504 loans), applicant provides explanation letter for derogatory credit

It's important to compare the information on the credit report with the Form RD 410-4, Uniform Residential Loan Application. Verify the applicant's name, address, and social security number; compare the employment information and rental data if available. If there are any questionable items, obtain a letter of explanation. Review recent inquiries and confirm if a new account was recently opened that is not reflecting on the TMCR and review if the applicant is responsible or only an authorized user.

If, and only if, the applicant has a credit score under 640, the Loan Originator should obtain the verification of rent/mortgage, & applicant reference letters to parties identified in the application.

If traditional credit is not used, or there are less than 2 scores, the Loan Originator must develop a credit history from at least 3 sources, which can be a combination of traditional and nontraditional sources. However, only two sources are required if one of those is a verification of rent or mortgage payments.

Review for Indicators of Unacceptable Credit handling outlined in Exhibit 4-4, and complete Form RD 1944-61, the Credit History Worksheet to conduct a full credit analysis. If the applicant does have derogatory credit, the Loan Originator should request a letter of explanation for the applicant to provide additional details.

Credit Disputes - Non-Derogatory Disputed Accounts

Non-Derogatory Disputed Accounts

If the Loan Originator can determine the non-derogatory disputed account acceptable, they can proceed with underwriting

The disputed account is considered non-derogatory if one of the following apply:

- The disputed account has a zero balance;
- The disputed account states "paid in full" or "resolved" on the credit report;
- The disputed account with late payments are aged 24 months or greater;
- The disputed account is current and paid as agreed.

What is needed?

- Documentation to support the reason and basis of the dispute with the creditor.
- Determine the Impact
- Include the minimum monthly payment stated on the credit report, five percent of the balance of the account, or the amount documented from the creditor

HB-1-3550, Paragraph 4.12 B states that consumers also have the right to dispute information on their credit report, which they believe to be inaccurate. This can be done directly with the furnisher of credit, as well as a consumer reporting agency. Generally, disputes are investigated by the consumer reporting agency(s) within 30 to 45 days of receipt of the notice of dispute from the consumer; and written results of the investigation are provided to the consumer within 5 business days after completion of the investigation. For more information visit https://www.ftc.gov/ and also, https://www.consumerfinance.gov/askcfpb.

If the applicant has a non-derogatory disputed account, the Loan Originator can determine the non-derogatory disputed account acceptable and proceed with underwriting. The disputed account is considered non-derogatory if one of the following apply.

- The disputed account has a zero balance;
- The disputed account states "paid in full" or "resolved" on the credit report;
- The disputed account with late payments are aged 24 months or greater; or

- The disputed account is current and paid as agreed.

The applicant must provide the Agency with applicable documentation to support the reason and basis of the dispute with the creditor. The Loan Originator must determine the impact of the disputed account on the repayment of the proposed mortgage debt. The Loan Originator must include the minimum monthly payment stated on the credit report, five percent of the balance of the account, or the amount documented from the creditor for each account.

Credit Disputes - Derogatory Disputed Accounts

Derogatory disputed credit accounts refer to:

- Charge-off accounts
- Disputed collection accounts
- Disputed accounts with late payments in the last 24-months

If there are derogatory disputed credit accounts:

- The Agency's credit determination may be subject to change upon resolution of the derogatory disputed accounts.
- Determine the Impact
- Include the minimum monthly payment stated on the credit report, five percent of the balance of the account, or the amount documented from the creditor
- Form RD 1944-59, Certificate of Eligibility may be issued, subject to the receipt of the disputed resolution prior to approval.

Disputed derogatory credit accounts refer to disputed charge-off accounts, disputed collection accounts, and disputed accounts with late payments in the last 24 months.

The Agency's credit determination may be subject to change upon resolution of the derogatory disputed account. The Loan Originator must determine the impact of the disputed accounts on the repayment of the proposed mortgage debt. The Loan Originator must include the minimum monthly payment stated on the credit report, five percent of the balance of the account, or the amount documented from the creditor for each account. The Loan Originator may issue Form RD 1944-59, Certificate of Eligibility, subject to the receipt of the disputed resolution prior to approval.

Credit Disputes – Excluded Disputed Accounts

The following disputed accounts can be excluded from consideration in the underwriting analysis:

- Disputed medical accounts and collections;
- Disputed derogatory accounts that are the result of identify theft, credit card theft, or unauthorized use when evidence (police report, attorney correspondence, creditor statement) is provided to support the applicant's explanation; or
- Disputed accounts of a non-purchasing spouse in a community property state

See HB-1-3550, Chapter 4, Paragraph 4.12 B. for further guidance on Disputed Accounts (non-derogatory, derogatory and excluded)

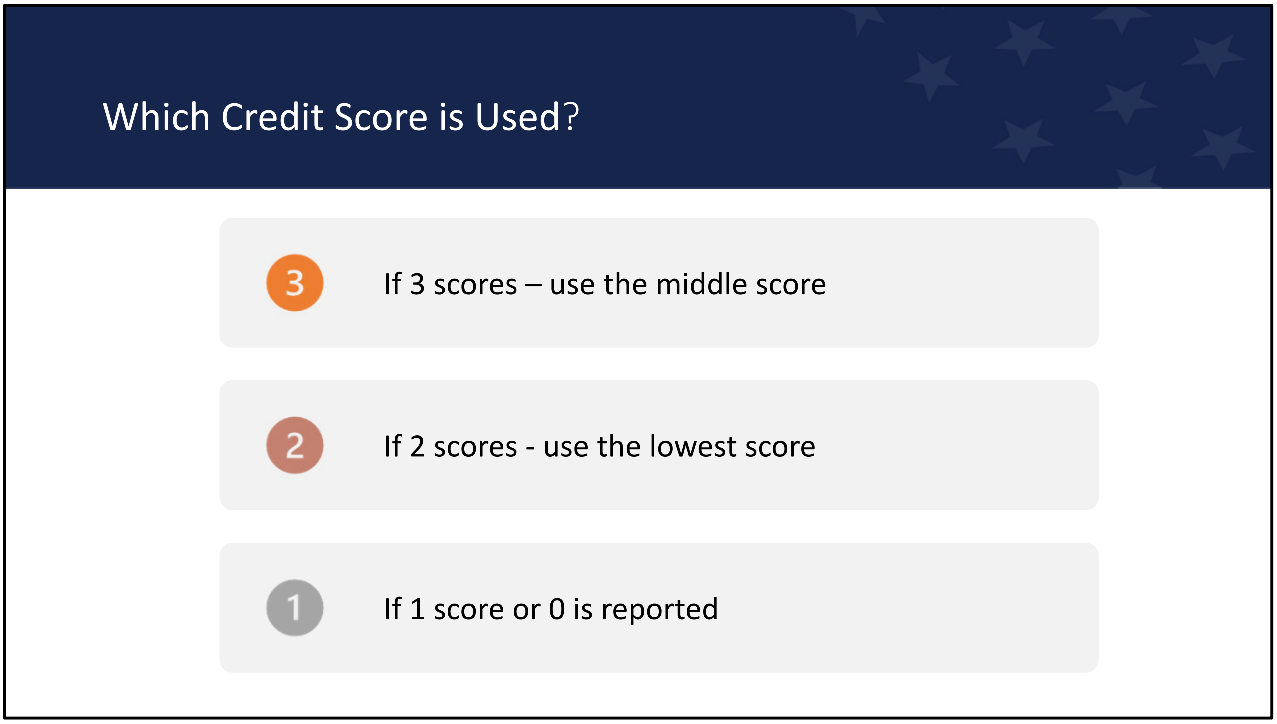
The following disputed accounts can be excluded from consideration in the underwriting analysis:

- Disputed medical accounts/collections;
- Disputed derogatory accounts that are the result of identity theft, credit card theft, or unauthorized use when evidence (police report, attorney correspondence, creditor statement) is provided to support the applicant's explanation; or
- Disputed accounts of a non-purchasing spouse in a community property state.

The FACT Act added a section to the Fair Credit Reporting Act to prohibit creditors from obtaining or using medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit.

Consumer reporting agencies are prohibited from providing a lender with a credit report that contains identifying information for medical debts (be it a collection, judgment, etc.). The name of the medical service provider and the nature of the medical service is suppressed or coded so that lender decisions are not based on discriminatory factors. However, suppression or coding of identifying information for medical debts does not eliminate the need for consideration. Medical debts that are chronically late, placed in collection, or turned into judgments remain indicators of unacceptable credit handling that must be addressed (unless the applicant has a credit score of 640 or higher).

Please refer to HB-1-3550, Chapter 4, Paragraph 4.12 B. for further guidance regarding non-derogatory, derogatory and excluded disputed accounts.



The TMCR may contain up to 3 credit scores for each applicant.

If the report contains 3 scores, the middle score is used; if there are 2 scores, the lowest score will be used. Having 2-3 scores indicates that there is an adequate depth of credit history.

However, if there is only one score or no score, then the applicant either has very little credit, or no credit history, the Loan Originator must complete a full/manual credit analysis using alternative/nontraditional credit verifications. For instance, an applicant may have a cell phone bill paid monthly that is not on the credit report, but billing statements could be used to document their willingness to pay their obligations. RD will conduct a full credit analysis using these alternate/nontraditional credit verifications.

It is important to note that nontraditional credit may never be used to enhance the credit of an applicant with a negligent credit history or to offset derogatory credit references found in the applicant’s traditional credit report.

The review and analysis of the credit report is completed for all applicants separately.

If there are two applicants and one has 3 scores, but the other has only 1, then alternate credit would be needed for the applicant with one score, and the references would need to indicate that the credit is in that applicant's name (either jointly or individually).

An infile credit report credit score is considered valid for unsecured Section 504 repair loans but cannot be used for denial of credit purposes.

Which Credit Score to Use - Example

Example A:
John Day & Mary Knight

John
700 640 620

Mary
640 630

Example B:
Ben Cherry & Jeri Garcia

Ben
580

Jeri
800 740 680

Let’s look at two examples to determine which credit score to use.

Example A is John Day and Mary Knight.
John has 3 credit scores: 700, 640, and 620. Because he has three scores, the middle score of 640 is selected as his score. Mary only has two scores: 640 and 630. Since she has two scores, the lower score of 630 is selected.

Example B is Ben Cherry and Jeri Garcia. Ben has one score of 580 which cannot be used and will require alternative credit verifications. Jeri has three scores, so like John in the first example, we use the middle score which in Jeri’s case is 740.

Streamlined Credit Analysis

Yes, when:

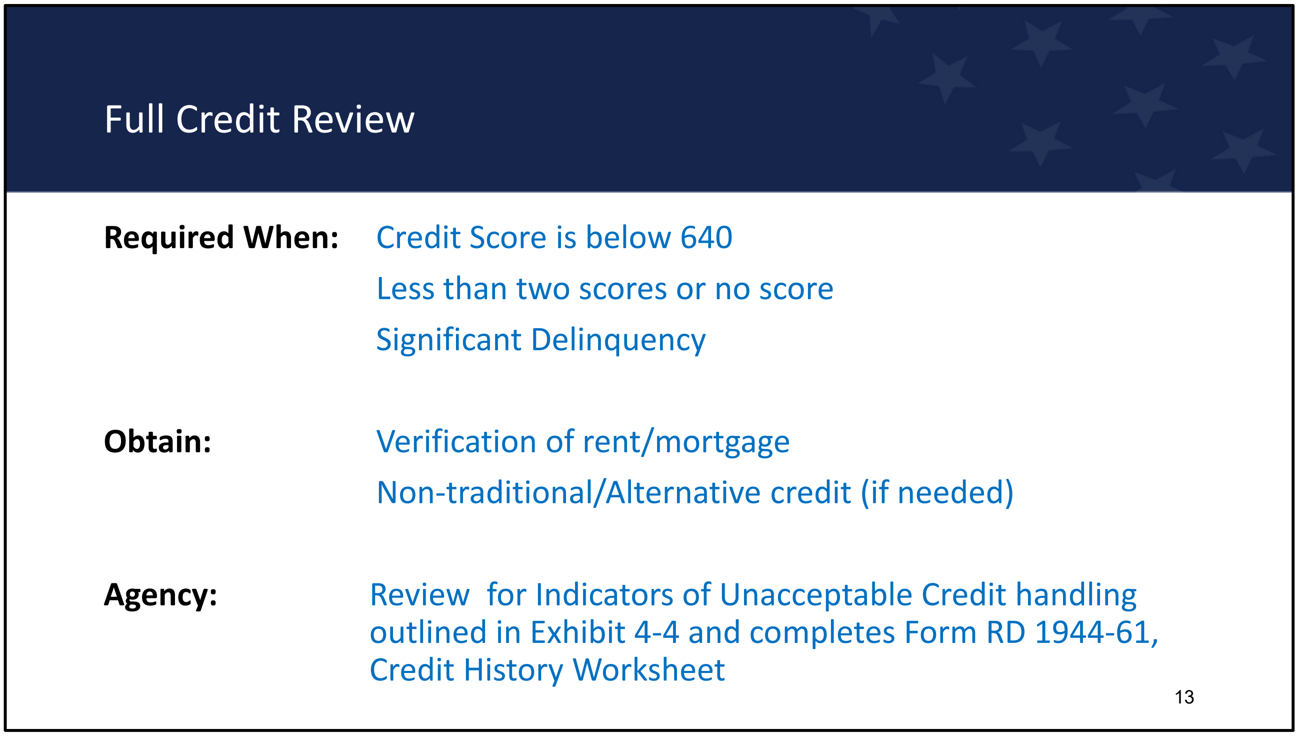
- 502 – Credit Score 640+
- 504 – Credit Score is 620+
- Two or more credit scores on the TMCR
- No outstanding federal judgments
- No significant delinquency
- No Do Not Pay (DNP) matches

Agency Action

Applicants qualifies for streamlined analysis and are classified as having acceptable credit

Streamlined credit analysis is used when the applicant has more than one credit score of 640 or above for the 502 Direct program and 620 or above for the 504 Repair Loan Program. Applicants must **not** have any outstanding federal judgments, significant delinquencies, and no matches on the Department of Treasury's Do Not Pay (DNP) portal.

Applicants who qualify for the streamlined credit analysis are classified as having an acceptable credit history, even if there are items (such as collections or late payments) reflected on their credit report. Those factors have been considered in the credit score. Exhibit 4-4, Indicators of Unacceptable Credit, landlord verification, and Form RD 1944-61 Credit History Worksheet are not required. These applicants are automatically classified as having an acceptable credit history. To avoid potential disparate treatment, additional credit analysis is not appropriate.



A full credit review is required when the applicant's credit score is below 640, has one or zero credit scores, or the applicant has a significant delinquency on the credit report (even with a credit score of 640 or above.)

If the applicant's credit score is less than 640 for 502 loans (or 620 for 504 loans), the Loan Originator must development a credit history from at least three sources. However, only two sources are required if one of those is a verification of rent or mortgage payments. A combination of traditional and nontraditional sources may be used to develop the credit history.

Other Credit Verifications include:

- Verification of rent – Form RD 1944-60, Landlord's Verification can be used to verify the past 2 years of rental history or obtaining the past 24 months of canceled checks, money order receipts, or electronic payment confirmation reflecting payments were made directly to the landlord.

- Applicant Reference Letter – Form RD 410-8 is used to obtain information about an applicant's credit history that might not appear on a credit report, for example, credit from a local store.

- Non-traditional credit/Alternative Credit – For applicants who do not use traditional credit, or that have less than two credit scores, nontraditional sources may be used to develop the credit history; and the nontraditional payments should have been made for at least 12 months within the past 24 months from the date of the credit report.   We will discuss nontraditional credit in further detail later in the module.

Payments made to relatives for credit sources are ineligible as a nontraditional credit reference.

Form RD 1944-61, Credit History Worksheet, must be used to summarize the applicant's credit history and to determine whether there are any Indicators of Unacceptable Credit as outlined in Exhibit 4-4. The Loan Originator should complete this form and include it in the case file to aid the Loan Approval Official in reviewing the applicant's credit history. The Loan Approval Official must confirm the completeness and accuracy of this form before making a credit decision.

HB-1-3550, Paragraph 1.9 D states: If the application is denied due to adverse credit, the supporting documentation should include a completed Form RD 1944-61, Credit History Worksheet, which must be signed by the Loan Approval Official. The analysis must document the consideration of paragraph 4.14(a) compensating factors and include the applicant's written explanation for derogatory credit.

Significant Delinquency

Regardless of their score, an applicant with a **significant delinquency** will be subject to further credit analysis and Form RD 1944-61 must be completed.

Significant Delinquency includes:

- A foreclosure, deed-in-lieu of foreclosure, short sale, or mortgage charge-off that has been completed within the last 36 months
- A Chapter 7 bankruptcy discharged less than 36 months prior to the application date
- Agency debt that was debt settled within the past 36 months or are being considered for debt settlement

Significant Delinquency is debt that reflects a high-risk situation where debts were not paid; however, they are not automatic disqualifiers.
An applicant with significant delinquency on the credit report, even with a credit score of 640 or higher, will be subject to further credit analysis and Form RD 1944-61 must be completed. The Loan Approval Official will need to determine the reason for the delinquency, what the applicant did to correct the situation and what the applicant's credit status is now.

Significant Delinquency includes:

- A foreclosure, deed-in-lieu of foreclosure, short sale, or mortgage charge-off that has been completed within the last 36 months
- A Chapter 7 bankruptcy discharged less than 36 months prior to the application date
- Agency debt that was debt settled within the past 36 months or is being considered for debt settlement

Significant Delinquency (Continued)

Chapter 13 bankruptcy, only if the applicant

- Did not complete the debt restructuring plan successfully (i.e., quit making payments) AND
- Has not made the last 12 months of payments according to the restructuring plan

Note: if currently in bankruptcy, need written authorization from bankruptcy court to incur RD loan

A Chapter 13 bankruptcy is a repayment plan that protects individuals from collection action during the plan period, from three to five years, and discharges any unpaid balance at the end of the plan. The repayment amount is determined by the court based on the individual's income.

An applicant with a Chapter 13 Bankruptcy reported on the credit report is considered to have a significant delinquency if the applicant:

- Does not successfully complete the debt restructuring plan (i.e., quit making payments), AND
- Has not made the last 12 months of payments according to the restructuring plan prior to the date of application. A

Please note, if the applicant has successfully completed the debt restructuring plan and made the last 12-months of payments under the bankruptcy restructuring plan, then the Chapter 13 bankruptcy is not considered unacceptable credit, and a credit exception is not required. The payment history from the bankruptcy repayment plan may be used to documents the applicant's willingness to repay debt. The Loan Originator will need to document that all required payments were paid on time and in the amount identified in the plan

However, If the applicant is currently in bankruptcy, the applicant must obtain written permission from the Bankruptcy Court to enter a financial obligation with the Agency.

What if the Applicant has a Significant Delinquency?

DO NOT

Consider the significant delinquency as an automatic disqualifier; it simply means the applicant does not qualify for streamlined review

DO
Investigate & Document:

- Why did it happen?
- What was done to correct it?
- What does the credit reflect now?

(Agency will use Form RD 1944-61, Credit History Worksheet)

Significant delinquencies do not automatically disqualify an applicant; if they exist, the streamlined credit analysis cannot be used, and a further review is needed.

Credit history problems may be more reflective of an inability to pay, than an unwillingness to meet the financial obligations. It may also be an indicator of extenuating circumstances, causing a significant reduction in income and/or an increase in financial obligations. The Agency may be able to make an exception if, in fact, the adverse credit was due to extenuating circumstances beyond their control and temporary in nature.

If there is significant delinquency, the Agency should investigate and document why it happened, what was done to correct it and what does the applicant's recent credit look like. Form RD 1944-61, Credit History Worksheet should be used to evaluate and analyze the applicant's credit.

Non-Traditional or Alternative Credit (No Score/Only One Score)

What is it?

- Payment history not reported to the credit bureau
- Payments made for at least 12-months within the past 24 months

How many are needed?

- A total of three credit sources (combination of traditional and alternative) are needed
- Two sources may be used if one of those sources is a verification of rent or mortgage payments

If the applicant has less than two credit scores, the Loan Originator must develop a credit history from at least three sources; which can be a combination of traditional and alternative credit.

Non-traditional or Alternative credit is a payment history from creditors who do not report to the credit bureau. A 12-month payment history is obtained from a third-party source to verify that payments have been made as agreed. The payments from non-traditional or alternative sources should have been made for at least 12-months within the past 24 months from the date of the application. The payment history can be in the form of Form RD 410-8, Applicant Reference Letter, copies of billing statements, cancelled checks, etc.

Non-traditional or Alternative credit can be combined with the traditional credit tradelines as reported on the credit report (remember that those tradelines need to meet the minimum payment activity history to be considered).

A total of three credit sources (combination of traditional and alternative) are needed.

OR

Two sources may be used if one of those sources is a verification of rent or mortgage payments.

Nontraditional/Alternative Credit Sources

Preferred Sources:
- Rental payments
- Utility (not included in rent)
- Internet/cell phone/cable TV payments
- Insurance payments not included in payroll deductions (auto, life, renter's, etc.)
- Personal loan with terms in writing supported with canceled checks (cannot be a relative of applicant)

Alternative Sources:
- Childcare (cannot be a relative)
- School tuition
- Payments to local retail stores
- Monthly Subscriptions (Hulu, Netflix, Xbox, etc.)
- Payment arrangements for medical bills
- Savings history (balance of 3-months of the estimated PITI)

The payment history may be obtained by sending Form RD 410-8, Applicant Reference Letter, to the nontraditional creditors indicated by the applicant or by obtaining canceled checks, money order receipts, billing statements, and/or payment history printouts from the creditor. Loan Originators should carefully evaluate the billing statements to establish the payment history and confirm there are no past due amounts or late payment charges. General statements such as “satisfactory” or “in good standing” are not sufficient to establish a satisfactory repayment history. When other payment installments are used, the length of the payment history should be adjusted accordingly. If the payments are made quarterly, verify that the last four payments were made. If the payments are made annually, verify that at least the last two payments were made.

The following are preferred and alternative nontraditional or alternative credit sources:

Preferred Sources: Rental housing; utilities (if not included in the rent payment); telephone service, cable television, and internet service; insurance payments (payroll deductions to pay for insurance premiums are not considered alternative credit). These expenses must not be included in the Total Debt (TD) ratio when calculating repayment ability.

Alternative Sources: Payments to childcare providers (provided the provider is an established childcare business); school tuition; payments to local retail stores; storage units companies; monthly subscriptions (e.g., Hulu, Netflix, Xbox, etc.), payment arrangements for the uninsured portion of any medical bills; a savings account reflecting regular deposits resulting in a balance equal to three months of the proposed mortgage payments; and similar credit sources. Child support paid is not an acceptable source. These expenses must not be included in the Total Debt (TD) ratio when calculating repayment ability.

Analyzing the Credit History

ACCEPTABLE CREDIT	INDICATORS OF UNACCEPTABLE CREDIT
Complete Form RD 1944-61, Credit History Worksheet Proceed with processing the application	Complete Form RD 1944-61, Credit History Worksheet **ASK and EVALUATE** Is it accurate? Why did it happen? What was done to correct it? Is it resolved? Either deny application or proceed with processing, depending on results of review

If the tradelines on the credit report and the non- traditional credit references indicate that payments have been paid as agreed, the Loan Originator will complete Form RD 1944-61, the Credit History Worksheet to document the results of the analysis and the Loan Approval Official will review the form for completeness and accuracy before making a credit decision.

Adverse credit items **are** considered INDICATORS of unacceptable credit. When the credit report and/or non-traditional references reflect indicators of unacceptable credit, this does not automatically make the applicant ineligible for a loan. The Loan Approval Official must ask and evaluate additional questions before making an eligibility determination:

1. Is it accurately reporting?
2. Why did it happen? The applicant will need to explain the circumstances that resulted in the delinquency. Was this because of an injury/accident that prevented the applicant from working for a period of time or did they forget to pay the bill?
3. What was done to correct the delinquency? Did the applicant make payment arrangements to bring the account current? Or did the delinquency remain

unpaid for a period of time?

4. Where is the credit now? In other words: has the applicant rebuilt their credit since that “one time” incident, or do they continue to have late payments to their creditors?

Depending on the results of that analysis, the application will either be denied, due to a lack of acceptable credit history, or the Loan Approval Official may determine that the applicant has an acceptable credit history and may continue processing the application.

Disqualifier

Regardless of their score, an applicant with an outstanding judgment obtained by the United States in a Federal court, other than the United States Tax Court, is not eligible.

This requirement is statutory and cannot be waived.

Indicators of Unacceptable Credit, which is outlined in Exhibit 4-4 in HB-1-3550, are general guidelines that aid in determining the degree of risk and are not absolute underwriting criteria.
If there is an Indicator of Unacceptable Credit on the Credit History worksheet, that is not an automatic disqualifier. The only automatic disqualifier is if the applicant has an outstanding judgment obtained by the United States in Federal Court, other than the United States Tax Court. This is a statutory requirement that typically cannot be waived; however, if there is a payment agreement in place, and it is in the Agency's best interest, an Administrator Exception may be requested.

Indicators of Unacceptable Credit

- Little or no credit history.
- Payments on any installment account, on a per account basis, not cumulative of any and all of these account types, where the amount of the delinquency exceeded one installment for more than 30 days within the last 12 months.
- Payments on any revolving account, on a per account basis , not cumulative of any and all of these account types, which was delinquent for more than 30 days on two or more occasions within the last 12 months.
- A foreclosure completed within the last 36 months.
- An outstanding IRS tax lien or any other outstanding tax liens with no satisfactory arrangement for payment.

As stated previously, the Indicators of Unacceptable Credit, which is outlined in Exhibit 4-4 in HB-1-3550, are general guidelines that should be used when reviewing eligibility.

If the applicant's credit score is below 640, or there is one or no credit score, Rural Development will determine if there are any indicators of unacceptable credit.

The Indicators of Unacceptable Credit include:

- Little or no credit history. The lack of credit history on the credit report may be mitigated if the applicant can document a willingness to pay recurring debts through other acceptable means such as third-party verifications or canceled checks. Third party verifications from relatives of household members are not permissible.
- Payments on any installment account, on a per account basis, not cumulative of any and all of these account types, where the amount of the delinquency exceeded one installment for more than 30 days within the last 12 months.
- Payments on any revolving account, on a per account basis, not cumulative of any

and all of these account types, which was delinquent for more than 30 days on two or more occasions within the last 12 months.

- A foreclosure that has been completed within the last 36 months
- An outstanding Internal Revenue Service (IRS) tax lien or any other outstanding tax liens with no satisfactory arrangement for payment

Indicators of Unacceptable Credit (Continued)

- Two or more rent or mortgage payments paid 30 or more days late within the last 2 years.
- Outstanding collection accounts with irregular payments/no satisfactory arrangements for repayment, or Collection accounts that were paid in full within the last 6 months, unless the applicant had been making regular payments previously.
- Non-Agency debts written off within the last 36 months, unless the debt was paid in full at least 12 months ago.
- Agency debts that were debt settled within the past 36 months or are being considered for debt settlement.
- Delinquency on a federal debt.

Additional Indicators of Unacceptable Credit include:

- Two or more rent or mortgage payments paid 30 or more days late within the last 2 years. If the applicant has experienced no other credit problems in the past 2 years, only 1 year of rent history will be evaluated.

- Outstanding collection accounts with irregular payments or no satisfactory arrangements for repayment, or collection accounts that were paid in full within the last 6 months, unless the applicant had been making regular payments previously

- Non-Agency debts written off within the last 36 months, unless the debt was paid in full at least 12 months ago

- Agency debt that was debt settled within the past 36 months or is being considered for debt settlement, and lastly

- Delinquency on a federal debt

As we discussed previously, Rural Development may determine that the cause of the adverse credit was beyond the applicant's control and they have since corrected or have made arrangements to correct the delinquency.

Remember that each applicant is evaluated on their own merits. An applicant with an acceptable credit history cannot compensate for a co-applicant with an adverse credit history. The analysis of the credit determines whether the applicant has an ability and a willingness to repay obligations.

We will review a few examples shortly.

Indicators of Unacceptable Credit (Continued)

- A court-created/affirmed obligation or judgment that is outstanding or has been outstanding (see Paragraph 8.5 regarding required clearance or approval upon closing), or has been outstanding within the last 12 months, **except**:
  - A bankruptcy in which:
    - Debts were discharged more than 36 months prior to the date of application (i.e., Chapter 7); or
    - A successfully completed bankruptcy debt restructuring plan (i.e., Chapter 13) which demonstrates a willingness to meet obligations when due for the 12 months prior to the date of application.
  - A judgment satisfied more than 12 months before the date of application.

The last Indicator of Unacceptable credit is:

- A court-created or court affirmed obligation or judgement caused by nonpayment that is currently outstanding (see Paragraph 8.5 regarding required clearance or approval upon closing), or has been outstanding within the last 12 months, <u>except</u>:
  - A bankruptcy in which:
    - Debts were discharged more than 36 months prior to the date of application; or
    - Where an applicant successfully completed a bankruptcy debt restructuring plan and has demonstrated a willingness to meet obligations when due for the last 12 months prior to the date of application.
  - A judgement satisfied more than 12 months before the date of application.

Evaluating Adverse Credit – Example A

Applicants:
John Day and Mary Knight

John's Credit Scores:
700, 620, 640,

Mary's Credit Scores:
640, 630

Analysis:
John –
Valid score of 640

Mary –
Score under 640
- One tradeline (open 6 months)
- Collection account - $500 balance
- No alternatives credit references in her name

The first example is John Day and Mary Knight.

In this example, John has 3 credit scores, so we will use the mid score of 640. Mary only has two scores, so we will use the lower score of 630.

John's credit report shows there are 3 or more tradelines; therefore his credit score is valid.

Mary's score is under 640. There is only one tradeline that has only been open for 6 months, and an unpaid collection account in the amount of $500 reflecting on her credit report. We asked Mary for alternative credit references, but she does not have anything in her name. Mary indicates that the collection account happened because she moved from the area and did not pay the outstanding utility bill. There is not enough evidence that Mary has the ability and willingness to repay the loan. There is an indicator of unacceptable credit reflecting on her credit report and she has not provided evidence that it was beyond her control or attempted to resolve the delinquency.

In this example, John has an acceptable credit history, but Mary does not. The application would be denied due to lack of acceptable credit because both applicants do not meet the credit requirements.

Evaluating Adverse Credit – Example B

Applicants:
Ben Gerry and Jeri Garcia

Ben's Credit Score:
580

Jeri's Credit Score:
800, 740, 680

Analysis:
Ben –
- Score of 580
- No adverse credit
- Low score due to lack of recent tradelines
- Obtained landlord reference & power bill

Jeri –
Score of 740
3 unpaid collection accounts

The second example is Ben Gerry and Jeri Garcia.

Ben has one score of 580.
His report indicates no adverse credit, but he has just one open and active tradeline. All the other accounts reflecting on his credit report are old, and inactive accounts. Alternative credit was requested to supplement the report. A landlord reference and a 12-month history of his monthly power bill was obtained. The payment history for alternative credit that was obtained reflect that he made his payments as agreed. Based on the combination of traditional and non-traditional sources, it is determined that Ben has acceptable credit. These findings must be documented on Form RD 1944-61, Credit History Worksheet.

Jeri has three scores and no significant delinquencies, so she qualifies for streamlined processing. She does not need to pay off the collection accounts, as those are factored into the score that is deemed acceptable by the Agency.

Exceptions to Credit Standards

RD may consider exceptions to the credit standards in the following situations:

- Reduced shelter costs
- Temporary situation
- Benefit to the government

Rural Development may grant an exception for the applicant’s adverse credit history, if:

1) **Making the loan will significantly reduce the applicant’s shelter costs**. For example, the applicant’s credit history indicates that for the last 3 months, they have had payments 30 days late. They explain that their rent went up to $1,000/month 4 months ago which was a $200/month increase from what they had been paying. They have been struggling to make all their payments on time since the rent increase. However, prior to the rent increase their credit report indicates that all payments were made on time. The loan amount requested will result in a payment of $750/month which reduces their shelter costs and would likely result in their ability to make the mortgage payment as well as other obligations.
2) **The circumstances were temporary and beyond the applicant’s control.** What this means is that the applicant may have adverse credit, but it is due to a reason beyond their control such as: unexpected loss of job, delay in benefits, inability to work due to injury, increased expenses due to illness, etc. And the issue is temporary in nature. As an example – the credit report shows excellent payments until 18 months ago. Then there is a 6-month period which reflects late

payments; but since then, all payments were paid on time. The applicant indicates that she was hit by a car 18 months ago, was unable to work for the first 2 weeks, then was on a part time basis for 3 months. She did not have any sick leave and did not qualify for other benefits and was unable to pay her bills on time. However, once she was on a full-time schedule, she made arrangements with the creditors and was able to bring her accounts current and has since paid her bills on time. In this example, it’s evident that the reason for the delinquency was beyond her control and she corrected the issue as soon as possible.

3) **Benefit to the Government.** In this case, the applicant may be delinquent on a Federal debt and by making the loan, the housing expenses will be reduced, allowing the applicant to take actions on that debt which will benefit the government. While this is an exception which can be considered, be aware that this requires review and approval by the Agency’s Administrator and is rare.

Credit Inquiries

What are they?

What type of debt?

How many?

Credit Inquiries
What are they? While credit inquiries are not necessarily an indicator of unacceptable credit, they are an indicator that an applicant may have recently applied for credit and may have increased their debt obligations. Since inquiries are typically a recent event, it’s important to ask the applicant questions about the inquiries.

What type of debt? If the applicant is applying for a car loan, this could be significant. A payment of $300 per month may mean that they no longer qualify for the loan amount requested. However, if they applied for a retail store credit card, with a small credit limit and a low payment, it may not have as much of an impact on their eligibility. It is important to find out the type of credit, the potential amount of debt and resulting payment, and if they have opened or intend to open the credit.

How many credit inquiries are reflected? The number of recent credit inquiries is also important. Opening credit card with a low credit limit is different than the applicant opening ten credit cards. It is important to review the number and dates of credit inquiries reflecting on the credit report.

Credit inquiries are an indication that the applicant may have additional debt that is not reflecting on the credit report; therefore, it is important to discuss recent credit inquiries with the applicant.

Govdelivery Notices

Sign up for Govdelivery to receive email updates on this program.

Using the link below, enter your email and select the "SFH Direct Loan and Grant Programs" (and any other programs of interest) and then click "Submit":

https://public.govdelivery.com/accounts/USDARD/subscriber/new?qsp=USDARD_25

If you haven't already, we encourage all staff to sign up for GovDelivery, which is a subscription service is used to provide updates regarding the:

- Program's interest rate,
- Changes to Handbook-1-3550,
- Certified packaging process,
- And much more.

In this webinar, we have examined the program's basic credit requirements.

If you are interested in learning more about the Section 502 Direct loan program, visit the website on this screen.

Finally, please note that the contents of this webinar is current as of this presentation's revision date. Please refer to Handbook-1-3550 for the most recent program guidance.