

RD AN No. 4346 (1980-D)  
March 28, 2008

TO: All State Directors  
Rural Development

ATTENTION: Rural Housing Program Directors,  
Guaranteed Rural Housing Specialists, and  
Area Directors, and Area Specialists

FROM: Russell T. Davis                    *(Signed by Russell T. Davis)*  
Administrator  
Housing and Community Facilities Programs

SUBJECT: Single Family Housing Guaranteed Loan Program  
Utilizing Credit Scores for Underwriting Single Family Housing  
Guaranteed Loans

**PURPOSE/INTENDED OUTCOME:**

The purpose of this Administrative Notice (AN) is to affirm 620 as the minimum Fair Isaacs & Company (FICO) credit score required for applicants to utilize streamlined documentation for manually underwritten guaranteed loans.

**COMPARISON WITH PREVIOUS AN:**

This AN replaces AN No. 4237 (1980-D) dated January 25, 2007. This AN includes new guidance for lenders when manually underwriting guaranteed loans with FICO scores below 620 as well as files with no credit scores. References to VantageScore have been removed from this AN, because this credit format is not used within the industry to a great extent and is not acceptable for the Single Family Housing Guaranteed Loan Program (SFHGLP) at this time.

EXPIRATION DATE:  
March 31, 2009

FILING INSTRUCTIONS:  
Preceding RD Instruction 1980-D

## **BACKGROUND:**

The SFHGLP continues to evaluate both loan performance and the real estate lending environment. SFHGLP loans with FICO scores over 620 historically experience significantly lower defaults than borrowers with scores below 619.

A recent SFHGLP portfolio review of FICO scores of 619 and below supports a thorough evaluation prior to extending mortgage credit:

- FICO score 619 and below:
  - \* 17% of SFHGLP portfolio
  - \* 39% of program losses
- No FICO score:
  - \* 6% of SFHGLP portfolio
  - \* 16% of program losses

Lenders should judiciously evaluate and carefully screen the credit histories of applicants with FICO scores of 619 and below for manually underwritten Guaranteed loan files.

## **IMPLEMENTATION RESPONSIBILITIES:**

### Selecting FICO Scores

The FICO score of the primary wage earner should be given the most emphasis; however FICO scores of other applicants should not be ignored. When reviewing appropriate credit reports select the correct FICO score for underwriting per these guidelines:

Three scores: Select the middle score

Two scores: Select the lowest score

One score: Use that score

No score: Non-traditional credit histories may be accepted

### Streamlined Documentation for FICO Scores of 620 or Higher

For loan applications that contain co-applicants, each applicant must have a FICO score of 620 or higher to qualify for streamlined documentation.

- A lender shall not be required to document adverse credit history waivers under RD Instruction 1980-D, section 1980.345(d), (referenced below in this AN) except for those involving a delinquent Federal debt or previous Agency loan.
- A lender shall not be required to document applicant rent payment history.

- No action will be necessary for any derogatory items, such as those outlined in RD Instruction 1980-D, section 1980.345(d), except for those involving a delinquent Federal debt or previous Agency loan.

Note that each applicant is treated separately. If the applicant has a score higher than 620 and the co-applicant has a score lower than 620, then the applicant qualifies for streamlined documentation but the co-applicant's credit history should be carefully examined.

FICO scores are calculated based upon credit information reported to the credit bureaus, therefore lenders and Agency staff can be confident that FICO scores of 620 and higher represent acceptable credit histories.

#### Applicants with FICO Scores of 619 and below

Based upon the portfolio review of SFHGLP loans, applicants with FICO scores of 619 and below have a statistically higher likelihood of default. This does not mean applicants with FICO scores of 619 and below are poor credit risks and should be categorically rejected. Many loans in this category are paid as agreed. However, underwriters should be especially cautious of layered risks in addition to the lower credit score which include but are not limited to:

- **Adverse credit history waivers:** Approved by the lender  
If the lender approves an adverse credit waiver for any instance of derogatory credit as outlined in RD Instruction 1980-D, section 1980.345(d), **the lender must secure documentation evidencing that the circumstances surrounding the adverse information were temporary in nature, and were beyond the applicant's control, and have been removed so their reoccurrence is unlikely.** Alternately, the lender must secure documentation evidencing that the delinquency arose from a justifiable dispute related to defective goods or services.
- **Ratio waivers:** Requested by the lender, approved by Rural Development Ratio waivers should be avoided unless strong compensating factors are present (i.e. Principal, Interest, Taxes and Insurance (PITI) is comparable to current housing, conservative user of credit, strong job history, demonstrated ability to accumulate reserves, etc.)
- **Payment Shock:** Approved by the lender  
Lenders should be cautious when applicants have no rent or housing history to verify, or the proposed PITI is 100% or greater than current rent or housing expense.

- **Questionable repayment income or job stability:** Approved by the lender The lender is responsible for calculating income and documenting the loan file.
  - Applicants with commission only positions or widely varying amounts of overtime and bonus income may not exhibit enough adequate or stable monthly income to qualify.
  - Applicants with gaps in their employment histories may not exhibit enough dependable or stable monthly income to qualify.

### Rent History Verification

Lenders are required to obtain a Verification of Rent (VOR) when available for all applicants with FICO scores of 619 and below. A 12 month history is most desired, however any length of payment history should be considered. Written verifications are preferred, but 12 months of cancelled checks covering the most recent 12 month period will also indicate a satisfactory payment history.

### Applicants with FICO scores of 580 and below

Loans with FICO scores of 580 and below are very high risk and tend to exhibit a much higher rate of default. Lenders should not approve loans with FICO scores of 580 and below if they exhibit any of the indicators of unacceptable credit per RD Instruction 1980-D, section 1980.345(d) which include:

- One or more debt payments being 30 days late within the last 12 months
- Foreclosure discharged less than 36 months
- Outstanding tax liens or delinquent government debts with no payment arrangements, currently due
- Outstanding judgments within the last 12 months
- Two or more rent payments 30 days late within the last 3 years
- Accounts converted to collections within the last 12 months
- Outstanding collection accounts with no payment arrangements that are currently due
- Bankruptcy discharged less than 36 months

Extraordinary compensating factors must be present to warrant a lender to issue an adverse credit waiver for applicants with FICO scores of 580 and below. Additional risk layering in addition to the lower score is not recommended.

## **SUMMARY**

Loan performance and current market conditions reveal a need to revisit acceptable parameters for SFHGLP loans. FICO scores are excellent indicators of acceptable credit, however the FICO score alone does not always give an accurate indication of an applicant's ability and willingness to repay a mortgage loan. Loan records must contain sufficient justification by the underwriter for approving the loan. The Uniform Underwriting Transmittal Summary is a good place to document this justification. The analysis should include an assessment of any compensating factors, or credit history explanations that establish the applicant's ability and willingness to repay the proposed loan as agreed. SFHGLP loans that are rejected by lenders based on underwriting risk should be rejected based on lack of repayment ability, lack of adequate and dependable income, inadequate credit history, or collateral that does not meet the required standards.

### **Lender Monitoring**

On an ongoing basis, Agency field staff should monitor originating lenders for adherence to SFHGLP loan underwriting requirements, including the standards outlined in this AN. Field staff conducting lender origination monitoring reviews should pay special attention to credit scores when reviewing first year delinquencies and early defaults.

Questions regarding this AN may be directed to Joaquin Tremols at (202) 720-1452 or Kristina Zehr at (309) 452-0830 ext. 111. Their respective email addresses are [joaquin.tremols@wdc.usda.gov](mailto:joaquin.tremols@wdc.usda.gov) and [kristina.zehr@wdc.usda.gov](mailto:kristina.zehr@wdc.usda.gov).