Liabilities for VA Loans

The Equal Credit Opportunity Act (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.

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.

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 five 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.
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.

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 down payment 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.

Required Search for and Treatment of Debts Owed to the Federal Government
There are two separate procedures the lender must follow in the Search Requirement. 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 a surviving spouse of a veteran who died on active duty or as a result of a service-connected disability.

2. For all applicants and co-obligors (veteran or non-veteran) on all VA loans including Interest Rate Reduction Refinancing Loans (IRRRLs), perform a CAIVRS inquiry (see next page for CAIVRS).
Debt Related to VA Benefits
Before processing a loan involving certain veterans, the lender must submit Verification of VA Benefit-Related Indebtedness 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 submit the completed form with the loan package. If the form indicates that the applicant receives non-service-connected pension or has been rated incompetent by VA, the loan cannot be closed automatically. Submit the loan for prior approval.

What is CAIVRS?
CAIVRS is a 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, the Small Business Administration, the Department of Education, HUD, and VA. The VA default information included in the database relates to overdue payments on education loans, overpayments on disability benefits income, and claims paid due to home loan foreclosures.
Applicant Presently Delinquent

If the CAIVRS screening indicates an applicant (or co-applicant) 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:

1. Suspend processing of the loan application.
2. Contact the applicant or co-applicant 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.
4. If the CAIVRS-provided point of contact does not provide a satisfactory solution, or if the applicant believes the CAIVRS information is erroneous, the lender must contact the agency point(s) of contact.

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-applicants may use CAIVRS. Any other use is unauthorized.

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.

Credit History

Credit Report Standards – Credit reports used in analyzing VA loans must be either:

A) Three-file Merged Credit Report (MCR), or
B) Residential Mortgage Credit Report (RMCR)

The credit report must be less than 120 days old (180 days for new construction).
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) are satisfactory credit risks 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. 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 non-installment obligations such as rent and utilities since the disruptive credit event.

**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.

**Adverse Data** – 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 of the last derogatory credit item. If the applicant and/or spouse are determined satisfactory credit risks in spite of derogatory credit information, include an explanation of the basis for the determination. 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. 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. Collection accounts do not necessarily have to be paid off as a condition for loan approval. 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.
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.

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. You may disregard a bankruptcy discharged more than two years ago. If the bankruptcy was discharged within the last one to two 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:

1. 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
2. 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. 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 and 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 two to three year period or, in some cases, up to five 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.

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.

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.

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.
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 down payment
- 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