



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

April 29, 2008

MORTGAGEE LETTER 2008-11

TO: ALL APPROVED MORTGAGEES

SUBJECT: Nontraditional Credit Verification and Evaluation

The Federal Housing Administration (FHA) has long permitted mortgage lenders to establish a borrower's credit history through nontraditional means, including the compilation of performance on rental payments; utility bills; telephone and cellular phone services; cable television service; payments to local stores, etc. This is further described in handbook HUD-4155.1 REV-5, paragraphs 2-3 and 2-4B.

This practice is appropriate when the borrower has insufficient trade lines with Equifax, Experian, or TransUnion and a credit bureau score cannot be derived. Mortgage lenders also may use nontraditional credit verification to augment "thin-file" credit reports where a credit score was generated but based on only a few trade lines. However, nontraditional credit reports may not be used to enhance any poor credit history on a traditional credit report.

This mortgagee letter provides guidance to lenders and underwriters for establishing and evaluating nontraditional credit histories and also describes FHA's acceptance of those enterprises that can develop a verifiable credit history, no less than 12 months in duration, for borrowers with limited traditional credit. This guidance is effective immediately but must be considered for borrowers without traditional credit beginning with case numbers assigned 30 or more days after the date of this mortgage letter.

Nontraditional Credit—Basic Guidance

The following provides guidance in establishing that a borrower has sufficient credit references for evaluating bill paying habits, which include: three (3) credit references, including at least one from Group I, covering the most recent 12 months activity from date of application. Group I references should be exhausted prior to considering Group II for eligibility purposes, as Group I is considered more indicative of a borrower's future housing payment performance. Borrowers with no Group I trade references will be underwritten using the criteria set forth under "insufficient credit" below.

Group I – rental housing payments (subject to independent verification if the borrower is a renter), utility company reference (if not included in the rental housing payment), including gas, electricity, water, land-line home telephone service, cable TV. If the borrower is renting from a family member, request independent documents to prove regularity of payments, such as cancelled checks.

Group II – insurance coverage, i.e., medical, auto, life, renter's insurance (not payroll deducted); payment to child care providers – made to a business providing such services; school tuition; retail stores – department, furniture, appliance stores, specialty stores; rent to own – i.e., furniture, appliances; payment of that part of medical bills not covered by insurance; Internet/cell phone services; a documented 12 month history of saving by regular deposits (at least quarterly/non-payroll deducted/no NSF checks reflected), resulting in an increasing balance to the account; automobile leases, or a personal loan from an individual with repayment terms in writing and supported by cancelled checks to document the payments.

Verifying Nontraditional Credit

We prefer all nontraditional credit references be verified by a credit bureau and reported back to the lender as a nontraditional mortgage credit report (NTMCR) in the same manner as traditional credit references. A NTMCR is designed to assess the credit history of the borrower without the benefit of institutional trade references and should format as traditional references – including creditor's name, date of opening, high credit, current status of the account, required payment, unpaid balance, and a payment history in the delinquency categories of 0x30, 0x60 etc. It should not include subjective statements such as “satisfactory, acceptable, etc.”

Only if a NTMCR is impractical or such a service is unavailable may a lender choose to obtain independent verification of trade references. Documents confirming the existence for a nontraditional credit provider may include a public record from the state, county, or city records, or other means providing a similar level of objective confirmation. To verify the credit information, lenders must use a published address or telephone number for that creditor and not rely solely on information provided by the applicant. Rental references from management companies with payment history for the most recent 12 months may be used in lieu of 12 months cancelled checks. Credit references may also be developed via independent verification directly to the creditor. If a method is used to verify credit information or rental references other than NTMCR, all references obtained from individuals should be backed up with the most recent 12 months cancelled checks.

In addition, FHA has no objection to the use of various service providers now operating that are able to develop a bill payment history, as well as a score by obtaining rental payment history, utility trade-lines, and other common recurring non-reporting bill payments. While we do not endorse any particular service provider, FHA approved lenders may use such services to develop a credit history for borrowers with no or little traditional credit.

Evaluating Nontraditional Credit

The following offers guidance in evaluating borrowers with nontraditional credit histories. A satisfactory credit history, at least 12 months in duration, is to include:

- No history of delinquency on rental housing payments
- No more than one 30-day delinquency on payments due to other creditors
- No collection accounts/court records reporting (other than medical) filed within the past 12 months

Insufficient Credit

The following offers guidance in evaluating borrowers with no credit references, or otherwise having only Group II references. A satisfactory credit history, at least 12 months in duration, is to include:

- No more than one 30-day delinquency on payments due to any Group II reference
- No collection accounts/court records reporting (other than medical) filed within the past 12 months

In addition, for such borrowers, to enhance the likelihood of homeownership sustainability, the following underwriting guidance is being provided:

- Qualifying ratios are to be computed only on those occupying the property and obligated on the loan, and may not exceed 31 percent for the payment-to-income ratio and 43 percent for the total debt-to-income ratio. Compensating factors are not applicable for borrowers with insufficient credit references.
- Borrowers should have two months of cash reserves following mortgage loan settlement from their own funds (no cash gifts from any source should be counted in the cash reserves for borrowers in this category).

If you have any questions regarding this Mortgagee Letter, call 1-800-CALLFHA.

Sincerely,

Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner