

Underwriting Reminders for Loan Prospector® Caution Risk Class Mortgages



This document provides helpful reminders for underwriting credit and capacity for mortgages receiving a Caution risk class from Loan Prospector. As always, individuals responsible for making the final lending decision should ensure that all requirements in the *Single-Family Seller/Service Guide* (Guide), as well as any corporate guidelines and policies, are met.

All Caution Mortgages (Guide Chapter 37)	
<p>Reconcile any material discrepancies between loan application and the credit report used to document the file.</p> <p>When the credit report indicates that a creditor has made an inquiry within the previous 120-day period, you must determine if additional credit was granted. A letter from the creditor or, if such a letter is unobtainable, a signed statement from the borrower may be used to determine whether additional credit was obtained. If additional credit was granted, verification of the debt must be obtained and the debt must be considered when qualifying the Borrower subject to the requirements in Section 37.16, Monthly debt payment-to-income ratio.</p>	
Caution with A-minus eligible message: Loan Prospector has determined that the credit reputation and ratios are acceptable, subject to certain manual eligibility checks. A postsettlement delivery fee applies. (Guide Chapter C33)	
Eligibility	<ul style="list-style-type: none"> Must receive the purchase eligibility message "500 Freddie Mac A-minus eligible" from Loan Prospector. Must be a conventional mortgage (other than 5-year Balloon/Reset Mortgage, Prepayment Protection Mortgage or Seasoned Mortgage). Assuming the mortgage meets all manual eligibility checks, then the mortgage must be delivered as an A-minus mortgage with the appropriate delivery fee. See Guide Chapter C33 for exceptions.
Manual checks	<ul style="list-style-type: none"> If not adequately shown on the credit report, directly verify payment history for all mortgage debt for the most recent 12 months. During the most recent 12 months, if any Borrower was 30 days or more delinquent more than once, or 60 days or more delinquent, on any directly verified mortgage or combination of directly verified mortgages, the mortgage is ineligible for delivery to Freddie Mac. If the subject property is an investment property, and the Borrower owns more than one financed property, the mortgage is not A-minus eligible.
Caution without A-minus eligible message – Borrower Credit: Manually underwrite all aspects of Borrower credit, capacity and collateral. A postsettlement delivery fee applies. (Guide Chapter 37)	
Due to Credit	<p>The Seller is responsible for demonstrating an acceptable credit reputation. When there are at least two Feedback Certificate messages related to nonpayment of obligations, the Seller must presume the derogatory information is significant. The Seller must document:</p> <ul style="list-style-type: none"> The decision the repository file contains showing significant inaccurate credit information, or Extenuating circumstances or conclusion that the difficulties were due to financial mismanagement, Credit-related offsets needed for the factors identified in the <i>Credit Risk Comments</i> and <i>Repository Reason Code Comments</i> sections of the Feedback Certificate necessary to ensure that the Mortgage is acceptable
Significant Inaccurate Information Requirements	<p>If the Seller determines the decision repository file used to create the Selected Borrower's credit report contains significant inaccurate credit information, the Seller must consider the Loan Prospector assessment invalid and manually underwrite the Mortgage as a Non-Loan Prospector Mortgage (see Section 37.5), and:</p> <ul style="list-style-type: none"> Disregard the inaccurate credit score and use an accurate score, if available. Provide written documentation in the mortgage file from the repository (or creditor) reporting the inaccurate information affirming error(s). <p>Deliver 'FICO unusable/inaccurate' (or 'I') in Credit Score Type (CST) field on delivery Form 11 (or Form 13SF) to note inaccurate credit (avoids fee).</p>

Note: Vertical revision bars " | " are used in the margin of this quick reference to highlight new requirements and significant changes

Caution without A-minus eligible message – Borrower Credit, *continued*

Significant Derogatory Credit Requirements Determine if significant derogatory credit is due to Extenuating Circumstances or Financial Mismanagement, then document according to Guide Section 37.7. For all area(s) of risk identified in the Credit Risk Comments and Repository Reason Codes, sufficient offsets *not already assessed by Loan Prospector* are required. (Guide Chapter 37)

The following subsections under Borrower Credit are Significant Derogatory Credit Requirements and based on Extenuating Circumstances and/or Financial Mismanagement requirements.

Evaluating credit reputation	<i>Extenuating Circumstances</i>	<i>Financial Mismanagement</i>
	<p>Freddie Mac considers an extenuating circumstance to be:</p> <ul style="list-style-type: none"> ▪ A nonrecurring or isolated circumstance, or set of circumstances, that was beyond the Borrower's control and ▪ That significantly reduced income and/or increased expenses, and ▪ Rendered the Borrower unable to repay obligations as agreed, resulting in significant adverse or derogatory credit information. <p>In addition, if the Borrower's credit history includes significant adverse or derogatory credit within the most recent two years, even if it was caused by extenuating circumstances, the Borrower's credit reputation cannot be considered acceptable.</p> <p>When the Seller uses extenuating circumstances to justify the Borrower's credit reputation is acceptable despite significant adverse or derogatory information, the Seller must confirm the extenuating circumstances and that the Borrower has reestablished an acceptable credit reputation. If the Seller cannot obtain third-party documentation confirming the extenuating circumstances and reestablishment of credit, it cannot consider the extenuating circumstance as an acceptable offset to significant adverse or derogatory credit information.</p>	<p>If the Seller is unable to document extenuating circumstances in accordance with Freddie Mac's requirements, then it must concluded the problems were due to financial mismanagement.</p>

Minimum Indicator Score The Mortgage must meet the Minimum Indicator Score requirements for manually underwritten mortgages. Refer to Guide Exhibit 25, Mortgages with Risk Class and/or Minimum Indicator Score Requirements.

Caution without A-minus eligible message – Borrower Credit, continued

Recovery Time Periods for reestablishing credit

<i>Extenuating Circumstances</i>	<i>Financial Mismanagement</i>
<p>Must have reestablished an acceptable credit reputation for a period of at least:</p> <ul style="list-style-type: none"> ▪ 36 months for a previous foreclosure* ▪ 24 months from the execution date of a deed-in-lieu of foreclosure* ▪ 24 months from the completion date of any short sale* ▪ 24 months after the discharge or dismissal of a bankruptcy, ▪ 24 months for all other significant adverse or derogatory credit information 	<p>Must have reestablished an acceptable credit reputation for a period of at least:</p> <ul style="list-style-type: none"> ▪ 84 months for a previous foreclosure* ▪ 48 months from execution date of a deed-in-lieu of foreclosure* ▪ 48 months from the completion date for a short short sale* ▪ 48 months after the discharge or dismissal date of a bankruptcy, other than a Chapter 13 bankruptcy ▪ 24 months after the discharge date of a Chapter 13 bankruptcy, or 48 months after the dismissal date of a Chapter 13 bankruptcy ▪ 60 months when the Borrower has filed more than one bankruptcy petition in the past seven years ▪ 48 months for all other significant adverse or derogatory credit information
<p>*For a previous foreclosure, conveyance of a deed-in-lieu or short sale, the Mortgage must either be a purchase transaction secured by a Primary Residence with a maximum LTV/TLTV/HTLTV of 90%, or a “no cash-out” refinance Mortgage meeting the requirements of Guide Chapter 24.</p>	
<p>If the Seller cannot obtain third-party documentation confirming the extenuating circumstances and reestablishment of credit, it cannot consider the extenuating circumstance as an acceptable offset to significant adverse or derogatory credit information.</p> <p>Documentation must support:</p> <ul style="list-style-type: none"> ▪ A written statement from the Borrower regarding the cause of the financial difficulties to outside factors beyond the Borrower’s control ▪ Third-party documentation confirming the events were beyond the Borrower’s control or an isolated occurrence <p>Evidence on the credit report and other documentation in the Mortgage file of the length of time since completion of the significant derogatory event to the date of application and of completion of the recovery time period requirements</p>	<p>Documentation must support:</p> <ul style="list-style-type: none"> ▪ A written statement from the Borrower regarding the cause of the financial difficulties ▪ Evidence the borrower has reestablished an acceptable credit reputation <p>Evidence on the credit report and other credit documentation in the Mortgage file of the length of time since completion of the significant derogatory event to the date of the application, and of completion of the recovery time period requirements</p>

Caution without A-minus eligible message – Borrower Credit, continued

Underwriting Analysis (Form 1077)	Extenuating Circumstances	Financial Mismanagement
	<p>The Seller must explain on the Form 1077 (or other document in the file) the rationale supporting its determination that:</p> <ul style="list-style-type: none"> ▪ The events causing the financial difficulties were beyond the Borrower's control, are not ongoing, and are unlikely to recur ▪ An acceptable credit reputation has been reestablished ▪ Freddie Mac also recommends that you provide calculations for significant qualifying data (income, assets, debts, reserves) and the reasoning for your lending decision. 	<p>The Seller must explain on the Form 1077 (or other document in the file) the rationale supporting its determination that:</p> <ul style="list-style-type: none"> ▪ Financial mismanagement is unlikely to recur ▪ An acceptable credit reputation has been reestablished. <p>Making a case that the Borrower is sufficiently willing to repay obligations when significant derogatory information was caused by financial mismanagement is very difficult. It will take a longer and more convincing reestablishment period to overcome derogatory information caused by financial mismanagement.</p> <p>Freddie Mac also recommends that you provide calculations for significant qualifying data (income, assets, debts, reserves) and the reasoning for your lending decision.</p>
Caution without the A-minus message – Borrower Capacity: Manually underwrite all aspects of Borrower credit, capacity and collateral. A postsettlement delivery fee applies. (Guide Chapter 37)		
Due to Capacity	You are responsible for demonstrating acceptable capacity, including when the Feedback Certificate contains credit risk comments related to capacity.	
Compensating Factors	<ul style="list-style-type: none"> ▪ The Seller may not use information already considered by Loan Prospector to determine that capacity is acceptable See Section 37.1(c) for factors considered by Loan Prospector. ▪ Factors not considered by Loan Prospector, such as the existence of verified income that is not included in the submission or energy savings from an energy-efficient property (see Section 37.15), may be used by the Seller in making a case that capacity is acceptable. 	
Unacceptable Capacity	<p>The Seller must presume the Borrower's capacity to repay is not acceptable when the following conditions exist</p> <p>The Mortgage is a Loan Prospector Caution Mortgage, and</p> <ul style="list-style-type: none"> ▪ The transaction is a cash-out refinance, and ▪ At least one Credit Risk Comment related to the monthly debt payment-to-income ratio is returned on the Feedback Certificate 	
Ratios	<ul style="list-style-type: none"> ▪ When either of the ratio guidelines (28%/36%) is exceeded, the Seller must prepare and retain in the mortgage file a written explanation justifying its underwriting decision. (Guide Sections 37.15, 37.16) ▪ The total-debt-to-income ratio must not exceed 45%. When the Borrower's monthly debt payment-to-income ratio exceeds 36%, the Seller must document in the file the justification for the higher qualifying ratio. (Guide Section 37.16) 	

Related Resources

- To access related information regarding quality control resources and fraud prevention, visit http://www.freddiemac.com/singlefamily/quality_control.html.
- For a comprehensive guide to underwriting loans using Loan Prospector, please refer to the Freddie Mac *Single-Family Seller/Servicer Guide*.

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