CHAPTER 4: CREDIT UNDERWRITING

Overview

Topic 1: General Underwriting Information

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Underwriting Information

VA Underwriting Standards require lenders to always utilize the following guidance when underwriting VA-guaranteed loans:

Lenders are encouraged to make VA loans to all qualified Veterans who apply. VA's underwriting standards are intended to provide guidelines for underwriters. Decisions must be based on sound application of the standards, and underwriters are expected to use good judgment and flexibility in applying underwriting guidelines. Not all possible circumstances are addressed therefore, underwriters must apply reasonable judgment and flexibility in administering this important Veterans' benefit.

b. Basic Requirements

By law, VA may only guarantee a loan when it is possible to determine that the Veteran is a satisfactory credit risk, and has present or verified anticipated income that bears a proper relation to the anticipated terms of repayment.

VA's underwriting standards are incorporated into VA regulations at 38 C.F.R. 36.4340 and explained in this chapter. This chapter addresses the procedures for verifications and analysis involved in underwriting a VA-guaranteed loan. In the event the lender fails to perform their responsibilities, VA may take administrative actions including removal of authority to underwrite and close VA loans.

c. Lender's Responsibility

Lenders are responsible for:

- developing all credit information,
- properly obtaining all required verifications and the credit report,
- ensuring the accuracy of all information on which the loan decision is based,
- complying with the law and regulations governing VA's underwriting standards, and with VA's underwriting policies, procedures, and guidelines, and certifying as to compliance with all of the above.

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Topic 1: General Underwriting Information, continued

d. Lender's Procedures

Digital signatures can be accepted as an original signature or wet signature as defined by the Electronic Signatures in Global and National Commerce Act, commonly referred to as the E-sign Act.

The procedures on the table below address only the credit underwriting of the loan. Chapter 5 of this handbook provides all procedures that must be completed when making a VA loan.

Table 1: Lender's Credit Underwriting Procedures

Step	Action
1	Initiate the VA and Credit Alert Interactive Voice Response System (CAIVRS) inquiries described in Topic 4, Subsection c of this chapter.
2	Obtain all necessary verifications. The borrower's authorization can be obtained separately for the lender's required verifications, or on one blanket authorization form. The Certificate of Eligibility (COE) obtained from WebLGY provides verification of the amount of the Veteran's available entitlement, verification of exempt/non-exempt from the VA Funding Fee, and the amount of VA monthly service connected disability compensation. Order the COE before ordering the VA appraisal. The tri-merged credit report and verifications can be ordered by the lender or its agent or a party designated by the lender to perform that function. However, these documents must always be delivered by the credit reporting agency or verifying party directly to the lender or its agent, and never to another party. VA only permits the Veteran to pay for the credit report invoiced amount, not any additional costs that the lender may incur through other parties for obtaining the credit report.
3	Complete VA Form 26-6393, *Loan Analysis*, in conjunction with a careful review of the loan application and supporting documentation. Provide any explanations in Item 47-Remarks. The form is not required for Interest Rate Reduction Refinancing Loans (IRRRL) except IRRRLs to refinance delinquent VA loans.
4	Indicate the loan decision in Item 51 of the VA Form 26-6393, *Loan Analysis*, after ensuring that the treatment of income, debts, and credit is compliant with VA underwriting standards.

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Topic 1: General Underwriting Information, continued

e. Underwriting Special Types of Loans

The underwriting standards and procedures explained in this chapter generally apply to purchase and regular "cash-out" refinance loans. However, some special underwriting considerations also apply and can be found in Chapter 7 of this handbook.

f. Refinancing Loans

The underwriting standards detailed in this chapter apply to purchases and regular "cash-out" refinances. IRRRLs generally do not require any underwriting unless the loan is delinquent. IRRRLs made to refinance VA loans 30 days or more past due must be submitted to VA for prior approval underwriting. The underwriter must have concluded that:

- the circumstances that caused the delinquency have been corrected, and
- the Veteran can successfully maintain the new loan.
- Refer to Chapter 6 of this handbook for details on all types of refinancing loans.

Topic 2: Income – Required Documentation and Analysis

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Underwriter's Objectives

It is the underwriter's objective to identify and verify income available to meet:

- the mortgage payment,
- other shelter expenses,
- debts and obligations, and
- family living expenses.

b. Effective Income

Income is considered effective when it is determined to be verifiable, stable and reliable, and anticipated to continue for the foreseeable future. Income analysis is not an exact science. It requires the lender to underwrite each loan on a case-by-case basis, using good judgement and flexibility when warranted.

To determine whether income is stable and reliable, the probability of continued employment must be determined through examination of the:

- borrower's past employment record,
- borrower's training, education, and qualifications for his or her current position, and/or
- type of employment.
- Only verified income can be considered in the repayment calculation.

c. Spousal Income

Verify and treat the income of a spouse who will be contractually obligated on the loan the same as you would the income of a Veteran borrower that will be obligated on the loan. However, to ensure compliance with the Equal Credit Opportunity Act (ECOA), do not ask questions about the income of the borrower's spouse unless the:

- spouse will be contractually liable,
- borrower is relying on the spouse's income to qualify,
- borrower is relying on alimony, child support, or separate maintenance payments from the spouse or former spouse, or
- borrower resides and/or the property is in a community property state.

In community property states, information concerning a spouse may be requested and considered in the same manner as for the borrower, even if the spouse will not be contractually obligated on the loan. See Topic 5, subsection a, of this chapter for additional guidelines for community property states when considering a spouse's debts and credit history.

The non-purchasing spouse's (NPS) credit history does not need to be considered; however, the NPS' liabilities must be considered to determine the extent of the household liabilities.

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d. ECOA Considerations

Always inform the borrower (and spouse, if applicable) that they do not have to divulge information on the receipt of child support, alimony, or separate maintenance. However, for this income to be considered in the loan analysis, it must be divulged and verified.

Income cannot be discounted because of sex, marital status, age, race, or other prohibited bases under ECOA.

e. Income from Non-Military Employment

Verify a minimum of 2 years of employment. Generally, in the borrower's current position, 2 years of employment is a positive indicator of continued employment.

If the borrower has been employed by the present employer less than 2 years:

- verify prior employment, plus present employment covering a total of 2 years, or
- provide an explanation of why 2 years of employment could not be verified,
- compare any different types of employment verifications obtained (such as Verification of Employment (VOE), paystub(s), W2s, and tax returns) for consistency, and
- clarify any substantial differences in the data that would have a bearing on the qualification of the borrower(s).

Use of Employment Verification Services

Lenders may use any employment verification service that provides the same information as the "full" verification generated through the "Work Number" for all applicants. Generally, this will include the following information:

- the current date,
- employer name and address,
- Veteran's full legal name, social security number (complete or truncated) and job title,
- employment status (Active or Inactive),
- length of employment and start date,
- salary rate and pay frequency,
- average hours per pay period,
- summary of year to date information including base pay, overtime, commissions and bonuses, and reference number for the verification.

A current paystub is not required with an automated employment verification service.

Additionally, any VA Form 26-8497, Request for Verification of Employment (VOE) may be an original, faxed, or emailed copy of the original. Previously, VA required an original VA Form 26-8497. The requirements for obtaining a paystub have not changed. Hence, the paystub may be an original or a copy certified by the lender to be a true copy of the original.

The lender may not charge a fee to obtain the employment verification information.

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Topic 2: Income – Required Documentation and Analysis, continued

e. Income from Non-Military Employment, continued

Verification with VA Standard Documentation

Acceptable verification consists of VA Form 26-8497, Request for Verification of Employment (VOE) or any format which furnishes the same information as VA Form 26-8497, plus:

- paystub(s) covering the most recent 30-day period with year-to-date information, if the employer normally provides a pay stub(s) to the borrower.
- if the employer does not indicate the probability of continued employment on the VOE, the lender is not required to request anything additional on that subject.

The VOE and paystub(s) must be no more than 120 days old (180 days for new construction) from the closing date.

- For loans closed automatically, the date of the VOE and pay stub(s) must be within 120 days of the date the note is signed (180 days for new construction) from the closing date.
- For prior approval loans, the date of the VOE and paystub(s) must be within 120 days of the date the application is received by VA (180 days for new construction) from the closing date.

The VOE must be an original document or an electronic copy. The paystub(s) may be an original, electronic, or a copy certified by the lender to be a true copy of the original document.

Additional documentation for a borrower(s) employed in building trades or other seasonal or climate-dependent work must provide, in addition to the standard documentation (VOE and pay stub(s)), the following:

- Documentation of the borrower's total earnings year-to-date,
- Signed and dated individual income tax returns for the previous 2 years, and
- If the borrower works out of a union, evidence of the union's history with the borrower.

Alternative Verification Documentation

Alternative documentation may be submitted in place of a VOE if the lender concludes that the borrower's income is stable, reliable, and anticipated to continue for the foreseeable future; that is, if the borrower's income qualifies as effective income. Two years of employment with the same employer is not required to reach this conclusion.

Alternative documentation consists of:

- paystub(s) covering at least the most recent 30-day period with year-to date information,
- W-2 Forms for the most recent 2 years, and/or
- telephone verification of the borrower's current employment.

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Topic 2: Income – Required Documentation and Analysis, continued

e. Income from Non-Military Employment, continued

Document the date of the verification and the name, title, and telephone number of the person with whom employment is verified.

If the employer is not willing to give telephone verification of the borrower's employment or if verification is in any way questionable, use standard documentation. Alternative documentation cannot be used.

Paystub(s) and W-2 forms may be originals, electronic, or copies certified by the lender to be true copies of the originals.

f. Borrower Employed for Less than 12 Months

Generally, employment less than 12 months is not considered stable and reliable. However, the lender may consider the employment stable and reliable if the facts and documentation warrant such a conclusion.

Determine whether the borrower's past employment, training, and/or education equipped him or her with particular skills that relate directly to the duties of their current position.

If the probability of continued employment is high based on these factors, then the lender may consider including the income in the total effective income.

An explanation of why income of less than 12 months duration was used must be documented on the VA 26-6393, *Loan Analysis*.

If the probability of continued employment is good, but not well supported, the lender may utilize the income if the borrower has been employed at 12 months, to partially offset debts of 6 to 24 months duration. An explanation of why income was used to offset debts must be documented on the VA 26-6393, *Loan Analysis*.

A borrower may have a valid offer of employment which will begin at or after the anticipated date of closing which can be verified. All data pertinent to underwriting procedures should be considered. However, a paystub(s) may not be available.

g. Recent History of Frequent Changes of Employment

Short-term employment in a present position combined with frequent changes of employment in the recent past requires special consideration to determine stability of income. Analyze the reasons for the changes in employment.

Give favorable consideration to changes for the purpose of career advancement in the same or related field.

Favorable consideration may not be possible for changes with no apparent betterment to the borrower and/or changes from one line of work to another.

If the lender includes the borrower's income, an explanation of why income of short-term employment was used, must be documented on VA Form 26-6393, *Loan Analysis*.

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Topic 2: Income – Required Documentation and Analysis, continued

h. Income from Overtime Work, Part Time Jobs, Second Jobs, and Bonuses

Generally, such income cannot be considered stable and reliable unless it has continued and is verified for 2 years. To include income from these sources as income:

- the income must be consistent,
- there must be a reasonable likelihood that it will continue in the foreseeable future based on its compatibility with the hours of duty and other work conditions of the borrower's primary job and,
- how long the borrower has been employed under such an arrangement.

The lender may use this income, if not eligible for inclusion in income, but verified for at least 12 months, to offset debts of 6 to 24 months duration. An explanation of why the income was used to offset must be documented on VA Form 26-6393, *Loan Analysis*.

i. Income from Commissions

Verify commission income by obtaining the VOE or other written verification which provides the following:

- the actual amount of commissions paid year-to-date,
- the basis for payments (salary plus commission, straight commission, or draws against commission, or other), and
- when commissions are paid bi-weekly, monthly, quarterly, semiannually, annually, or other.
- individual income tax returns, signed and dated, plus all applicable schedules for the previous 2 years (or additional periods if needed to demonstrate a satisfactory earnings record).

Analyze Income Derived from Commissions

Generally, income from commissions is considered stable when the borrower has obtained such income for at least 2 years. Employment for less than 2 years cannot usually be considered stable unless the borrower has had previous related employment and/or specialized training. Employment of less than 1 year can rarely qualify; however, in-depth development is required for a conclusion of stable income on less than 1 year cases.

For a borrower who will qualify using commission income of less than 25 percent of the total annual employment income, IRS Form 2106 expenses are not required to be deducted from income even if they are reported on IRS Form 2106. Additionally, the expenses are not required to be added as a monthly liability for the borrower.

For a borrower earning commission income that is 25 percent or more of annual employment income, IRS Form 2106 expenses must be deducted from gross commission income regardless of the length of time the borrower has filed the expenses with the IRS.

One exception is an automobile lease or loan payment. An automobile lease or loan payments are not subtracted from the borrower's income; they are considered part of the borrower's recurring monthly debts/obligations in Section D on VA Form 26-6393, *Loan Analysis*.

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Topic 2: Income – Required Documentation and Analysis, continued

j. Self-Employment Income Analysis Guidelines

Obtain a current financial statement in an industry recognized accounting format including:

- Year-To-Date Profit and Loss statement (if the most recent year's tax return has not yet been prepared, provide a profit and loss statement for that year),
- current Balance Sheet, and
- individual income tax returns, signed and dated, plus all applicable schedules for the previous 2 years (or additional periods if needed to demonstrate a satisfactory earnings record).
- If the business is a corporation or partnership, include copies of the signed federal business income tax returns for the previous 2 years with all applicable schedules, and a list of all stockholders or partners showing the interest each holds in the business.

The financial statements must be sufficient for an underwriter to determine the necessary information for loan approval.

Financial Statements, including a year-to-date Profit and Loss Statement and Balance Sheet must be completed after one-half of the tax-year has passed to verify current income and stability of the income.

The lender may require an accountant or Certified Public Accountant-prepared financial statements if needed to make such a determination due to the nature of the business or the content of the financial statements

Analyze Income Derived from Self-Employment

Generally, income from self-employment is considered stable when the borrower has obtained such income for at least 2 years. Less-than-2-years cannot usually be considered stable unless the borrower has had previous related employment and/or specialized training. Less-than-1-year can rarely qualify; however, in-depth development is required for a conclusion of stable income on less-than-1-year cases.

Determine whether the business can be expected to generate sufficient income for the borrower's future needs.

If the business shows a steady or significant decline in earnings over the period analyzed, the reasons for such decline must be analyzed to determine whether the trend is likely to continue or be reversed.

If it is difficult to determine the probability of continued operation, obtain documentation on the viability and potential future earnings, and an explanation of the function and financial operations of the business from a qualified party.

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Topic 2: Income – Required Documentation and Analysis, continued

j. Self-Employment Income Analysis Guidelines, continued

Deductions and Expenses Claimed on Tax Returns

Depreciation claimed as a deduction on the tax returns and financial statements of the business may be included in effective income.

Business or roll over losses must be considered from all tax returns.

What is reported to the IRS on a joint return must be used when applying for a federally guaranteed loan.

On a joint tax return, the loss must be deducted from the borrower's income in both community and non-community property states.

On a joint tax return, when a borrower and co-borrower have been faced with business losses, the Veteran/borrower and his/her spouse may want to consider both being on the loan in order to potentially qualify. The credit of both borrowers will be considered.

k. Active Military Borrower's Income

For active-duty military borrowers, a Leave and Earnings Statement (LES) is required instead of a VOE. The LES must be an original, electronic, or a copy certified by the lender to be a true copy of the original.

The LES must furnish the same information as a VOE and must be no more than 120 days old (180 days for new construction), from the date of closing.

For loans closed automatically, the date of the LES must be within 120 days of the date the note is signed (180 days for new construction).

For prior approval loans, the date of the LES must be within 120 days of the date the application is received by VA (180 days for new construction).

In addition, identify servicemembers who are within 12 months of release from active duty or the end of their contract term. For an enlisted servicemember, find the date of expiration (ETS) of the borrower's current contract for active service on the LES. For National Guard or Reserve members, find the ETS of the borrower's current contract on the LES. Also, if a National Guard or Reserve member is currently serving on active duty, also identify the expiration date of the current active-duty tour. If the date is within 12 months of the projected date that the loan will close, the loan package must also include one of the following items, or combinations of items, to be acceptable:

- documentation that the servicemember has already re-enlisted or extended his/her period of active duty to a date beyond the 12-month period following the projected closing of the loan, or
- documentation that the servicemember has already re-enlisted or extended his/her period of active-duty service to a date beyond the 12-month period following the projected closing of the loan, or

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k. Active Military Borrower's Income, continued

- verification of a valid offer of local civilian employment and/or verification of military retirement income following the release from active-duty service, or
- verification of a valid offer of local civilian employment and/or verification of military retirement income following the release from active-duty service, or
- a statement from the servicemember that he/she intends to re-enlist or extend his/her period of active-duty service to a date beyond the 12- month period, plus (1) a statement from the servicemember's commanding officer confirming that the servicemember is eligible to re-enlist or extend his/her active-duty service as indicated, and (2) the commanding officer has no reason to believe that such re-enlistment or extension of active-duty service will not be granted, or
- documentation of other unusual strong positive underwriting factors, such as a downpayment of at least 10 percent from the borrower's own assets (not a gift), a minimum of 6 months PITI, in cash, after the downpayment from the borrower's own assets (not a gift) or clear evidence of strong ties to the community coupled with a non-military spouse's income so high that only minimal income from the active-duty servicemember is needed to qualify.

If an Officer has an ETS date listed as 888888 or 000000 on his or her LES, the above documentation is not required unless there is evidence that the Officer has resigned his or her commission.

Example: An Active Duty Veteran's LES indicates her ETS date listed on her LES is 171031 (October 31, 2017) and the projected date of closing is October 1, 2017. Therefore, one of the above items is needed to verify future income since her ETS date is less than 12 months from the projected date of closing.

Example: A member of the Reserves has been called to Active Duty. The ETS date on his LES indicates 181031 (October 31, 2018); however, his active duty orders indicate his active duty tour will not exceed the next 60 days.

Therefore, since he will be leaving active duty before 12 months of the projected closing date, the active-duty income cannot be considered, and his civilian employment and drill duty will need to be considered.

Example: An Active Duty Veteran's LES indicates his ETS date is less than 1 month from the anticipated date of closing, and he indicates he will be receiving military retirement and has accepted civilian employment. Verify his future retirement income from the Department of Defense and verify future civilian employment with the Veteran's new employer.

Analysis of Base Pay

Consider the borrower's base pay as stable and reliable unless the borrower is within 12 months of release from active-duty service. Analyze the additional documentation submitted. If the borrower will not be re-enlisting, determine whether the borrower's anticipated source of income is stable and reliable, and/or unusually strong underwriting factors compensate for any unknowns regarding future sources of income.

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Topic 2: Income – Required Documentation and Analysis, continued

k. Active Military Borrower's Income, continued

If an Officer has an ETS date listed as 888888 or 000000 on his or her LES, the above documentation is not required unless there is evidence that the Officer has resigned his or her commission.

Analysis of Military Quarters Allowance/ Basic Allowance for Housing (BAH)

Include a military quarters allowance in effective income if properly verified. In most areas, there will be an additional variable housing allowance, which can also be included. The military quarters and variable housing allowances are not taxable income. The lender must verify the amount of BAH the Veteran will receive. The BAH amount will change from one duty station to another.

Ensure that the borrower meets the occupancy requirements set forth in Chapter 3 of this handbook.

Verification and Analysis of Basic Allowance for Subsistence (BAS) and Clothing Allowances

Any subsistence (rations) and clothing allowances are indicated on the LES. The lender may include verified allowances in effective income. These allowances are not taxable income. The clothing allowance generally appears on the LES as an annual amount. Convert the annual amount to a monthly amount for the Loan Analysis.

Verification and Analysis of Other Military Allowances

To consider a military allowance in the underwriting analysis, obtain verification of the type and amount of the military allowance, how long the borrower has received it and the continuance into the foreseeable future.

Military allowances may be included in effective income only if such income can be expected to continue because of the nature of the borrower's assigned duties. Such allowances include, but are not limited to:

- proficiency pay, such as linguistic, parachute, scuba, flight or hazard pay, and
- overseas or combat pay (sea pay, submarine, etc.)

All types of allowances above are subject to periodic review and/or testing of the recipient to ascertain whether eligibility for such pay will continue. Only if it can be shown that such pay has continued for a prolonged period and can be expected to continue because of the nature of the recipient's assigned duties, should the income be added to base pay. Contact the borrower's chain of command if there are questions regarding the continuance of the income.

If the duration of the military allowance cannot be determined, this source of income may still be used to offset short term obligations of 6 to 24 months duration.

Consult the IRS to determine if any allowances for pay are considered taxable income by the IRS, unlike housing, clothing, and subsistence allowances.

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Topic 2: Income – Required Documentation and Analysis, continued

l. Income and Analysis of Income from Service in the Reserves or National Guard

Income derived from service in the Reserves or National Guard may be used if the borrower has served in such capacity for a period of time sufficient to indicate a good probability that such income will continue beyond 12 months. The total period of active-duty and reserve service may be helpful in this regard. Otherwise, this income may be used to offset obligations of 6 to 24 months duration.

Income from Recently Activated Members of the Reserve or National Guard

Lenders must consider if a borrower, whose income is being used to qualify for a loan, may have a change in income due to participation in a Reserves/National Guard unit subject to activation.

If an activated Reserves/National Guard member applies for a loan, they must present orders indicating their current active duty tour is not to exceed 12 months.

Example: The borrower's full-time civilian employment is $3,000 per month. The borrower's current income from the Reserves due to activation is $3,500 per month and orders are for 12 months. Since the borrower's full-time civilian employment is only $3,000 per month, the $3,000 should be used to qualify the borrower.

There are not any clear-cut procedures that can be applied to all cases. Evaluate all aspects of each individual case, including credit history, accumulation of assets, overall employment history, and make the best decision for each loan regarding the use of income in qualifying for the loan.

It is very important that loan files be carefully and thoroughly documented, including any reasons for using or not using Reserve/National Guard income in these situations.

As a lender, the goal is to provide the Veteran their benefit without placing him/her in a financial hardship.

m. Verification and Analysis of Income of Recently Discharged Veterans or Veterans to be Discharged from the Military

See the Income from Non-Military Employment in Topic 2, subsection e of this chapter for verification requirements.

Obtain verification that any of the following income types apply:

- employment income,
- retirement income, and/or
- VA disability income.

VA disability income is considered a benefit and does not need to be documented for the likelihood of continuance.

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Topic 2: Income – Required Documentation and Analysis, continued

m. Verification and Analysis of Income of Recently Discharged Veterans or Veterans to be Discharged from the Military, continued

VA disability income verification will be placed on the COE. However, there are some instances where this income is not placed on the COE which may include if the Veteran:

- will be discharging within the next 6 months from the military and has completed a Physical Exam Board (PEB) or Medical Review Board (MEB) and will be filing for VA disability while still on active duty,
- has recently filed for VA disability and VA's Compensation Service has not yet made a determination and would be entitled to receive 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 an unmarried surviving spouse of a Veteran who is eligible for or receiving qualifying Disability and Indemnity Compensation (DIC), or
- is in receipt of a VA nonservice connected pension, or
- has a VA-appointed Fiduciary to handle financial matters.

If the Veteran falls under one of the above categories, perform the following:

- Submit by fax VA Form 26-8937, Verification of VA Benefits, to the VA Regional Loan Center (RLC) where the subject property is located. VA will complete and return the form to the lender by return fax.
- Provide any supporting documents, including the COE, if it states to send VA Form 26-8937, Verification of Benefits to VA, to verify a Veteran's monthly income from VA.

Please note that if VA's Compensation Service has not yet issued a memo rating and/or completed a claim for a Veteran, then the amount the Veteran may receive in the future cannot be determined until the claim has been completed.

Until the Veteran begins receiving the monthly award, the amount cannot be placed on the COE. A VA awards letter can be used to verify the amount and date a future monthly VA compensation award will begin. However, the COE may be updated to reflect if the Veteran is exempt from paying the VA funding fee on a future disability award. See Chapter 8 of this handbook for funding fee exemptions.

The loan cannot be submitted for prior approval, or approved under the automatic procedure, until the lender obtains the completed form from VA when the Veteran or surviving spouse is under one of the above categories in subsection m of this topic. The lender must maintain the completed form with the loan package.

If the form indicates that the borrower receives a non service-connected pension or has a VA Fiduciary, the loan cannot be closed automatically. The loan must be uploaded in WebLGY for prior approval. See Chapter 5 of this handbook for the necessary documentation that must be submitted to VA.

VA must review, underwrite, and issue a Certificate of Commitment before the loan can close. See Chapter 5 of this handbook for prior approval procedures.

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m. Verification and Analysis of Income of Recently Discharged Veterans or Veterans to be Discharged from the Military, continued

VA's Pension Service may also have to review and/or approve the application in addition to Loan Production. The VA RLC will coordinate with the Pension Service upon receipt of the underwriting package.

Allow for additional processing time of a prior approval loan application when Compensation and/or Pension Service must also review.

Analysis of Prospects for Continued Employment

Cases involving recently discharged Veterans often require the underwriter to exercise a great deal of judgment and flexibility in determining whether the employment income will continue in the foreseeable future. This is because some Veterans may have little or no employment experience other than their military occupation.

Continuity of employment is essential for a Veteran with no retirement income, or insufficient retirement income, to support the loan obligation. If the duties the borrower performed in the military are similar or directly related to the duties of the present position, use this as one indicator that the employment is likely to continue.

Most cases fall somewhere between these extremes. Fully develop the facts of each case to make a determination. The guidelines under Self-Employment Income in Topic 2, subsection j of this chapter provide guidance for a recently discharged Veteran who is self-employed.

n. Rental Income

When all or a portion of the borrower's income is derived from rental income, documentation and verification of the income are necessary to determine the likelihood of continuance.

Verification of Rental Offset of the Property Occupied Prior to the New Home

Obtain a copy of the rental agreement for the property, if any.

Analysis using Rental Offset of the Property Occupied Prior to the New Loan

Use the prospective rental income only to offset the mortgage payment on the rental property, and only if there is not an indication that the property will be difficult to rent. This rental income may not be included in effective income.

Obtain a working knowledge of the local rental market. If there is not a lease on the property, but the local rental market is very strong, the lender may still consider the prospective rental income for offset purposes. Provide a justification on VA Form 26-6393, *Loan Analysis.*

Reserves are not needed to offset the mortgage payment on the property the Veteran occupies prior to the new loan.

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Topic 2: Income – Required Documentation and Analysis, continued

n. Rental Income, continued

Example [Rental Offset of the Property Occupied Prior to the New Loan]: The Veteran's current home has a VA mortgage with a monthly PITI payment of $1,000. Bonus entitlement is being used to purchase a new primary residence and the Veteran will rent the previous home for $1,200 monthly upon closing of the new home. The payment of $1,200 can be used to offset the existing mortgage payment, if all the above conditions are met. The additional rent received in excess of the mortgage payment cannot be used as effective income.

Verification of Rental Property Income

Obtain the following:

- documentation of cash reserves totaling at least 3 months mortgage payments (PITI), and
- individual income tax returns, signed and dated or lender obtained tax transcripts, plus all applicable schedules for the previous 2 years, which show rental income generated by the property.

If the borrower has multiple properties, the borrower must have 3 months PITI documented for each property to consider the rental income.

If there is not a lien on the property, 3 months reserves to cover expenses such as taxes, hazard insurance, flood insurance, homeowner's association fees, and any other recurring fees should be documented for the property(ies).

Equity in the property cannot be used as reserves.

Cash proceeds from a VA refinance cannot be counted as the required PITI on a rental property. The reserve funds must be in the borrower's account before the new VA loan closes.

Gift funds cannot be used to meet reserve requirements.

Analysis of Rental Property Income

Each property(ies) must have a 2-year rental history itemized on the borrower's tax return.

Property depreciation claimed as a deduction on the tax returns may be included in effective income.

If after adding depreciation to the negative rental income, the borrower still has rental loss, the negative income should be deducted from the overall income as it reduces the borrower's income.

If rental income will not, or cannot be used, then the full mortgage payment should be considered and reserves do not need to be considered.

Continued on next page

Topic 2: Income – Required Documentation and Analysis, continued

n. Rental Income, continued

Verification of Multi-Unit Property Securing the VA loan

The Veteran/borrower must occupy one unit as his/her residence.

For purposes of determining the VA guaranty, lenders are instructed to reference only the One-Unit Limit column in the FHFA Table "Fannie Mae and Freddie Mac Maximum Loan Limits for Mortgages, located at https://www.fhfa.gov/DataTools/Downloads.

Verify cash reserves totaling at least 6 months mortgage payments (PITI), and documentation of the borrower's prior experience managing rental units and/or use of a property management company to oversee the property.

Analysis of Multi-Unit Property Securing the VA loan (Veteran will occupy one unit as his/her residence)

Include the prospective rental income in effective income only if:

- the borrower has a reasonable likelihood of success as a landlord, and
- cash reserves totaling at least 6 months mortgage payments (PITI).

If each unit is separate and not under one mortgage, 6 months PITI must be verified for each separate unit.

Equity in the property cannot be used as reserves to meet PITI requirements. This must be the borrower's own funds, not a gift.

Cash proceeds from a VA regular "Cash-Out" refinance cannot be counted as the required PITI on a rental property. The reserve funds must be in the borrower's account before the new VA loan closes.

The amount of rental income to include in effective income is based on 75 percent of the amount indicated on the lease or rental agreement unless a greater percentage can be documented (existing property).

The amount of rental income to include in effective income is based on 75 percent of the amount indicated on the appraiser's opinion of the property's fair monthly rental (proposed construction).

Continued on next page

Topic 2: Income – Required Documentation and Analysis, continued

o. Temporary Boarder Rental Income Single Family Residence

The verification of temporary boarder rental income requires the following:

- individual income tax returns, signed and dated, plus all applicable schedules for the previous 2 years, which show boarder income generated by the property, and
- the rental cannot impair the residential character of the property and cannot exceed 25 percent of the total floor area.

Analysis of Temporary Boarder Rental Income

Include rental income in effective income only if the borrower has a reasonable likelihood of continued success due to the strength of the local market. Provide a justification on VA Form 26-6393, *Loan Analysis*.

PITI reserves are not necessary to consider the income, and all the income may be used in the analysis.

p. Alimony, Child Support, and Maintenance Payments

Verify the income if the borrower wants it to be considered. The payments must be likely to continue for at least 3 years from the anticipated closing date to include them in effective income.

Factors used to determine whether the payments will continue include, but are not limited to:

- whether the payments are received pursuant to a written agreement or court decree,
- the length of time the payments have been received,
- the regularity of receipt, and
- the availability of procedures to compel payment.

See "ECOA Considerations" in Topic 2, subsection d of this chapter.

q. Automobile or Similar Allowances

Generally, automobile allowances are paid to cover specific expenses related to a borrower's employment, and it is appropriate to use such income to offset a corresponding car payment. However, if the borrower reports an allowance as part of monthly qualifying income, it must be determined if the automobile expense reported on IRS Form 2106 should be deducted from income or treated as a liability.

If the reported expense is less than the automobile allowance, the amount can be treated as income and added to borrower's monthly income.

If the reported expense exceeds the automobile allowance, the amount must be deducted from income as a net calculation in Section D on VA Form 26-6393, *Loan Analysis*.

Likewise, any other similar type of allowance received by the borrower should be considered with regards to the tax returns for determination of an offset of the corresponding obligation, as income, or as an expense.

Continued on next page

Topic 2: Income – Required Documentation and Analysis, continued

r. Other Types of Income

While not all types of income can be listed, documentation of income must support the history of receipt and the likelihood or continuance of the income for at least 3 years from the anticipated closing date to include in effective income. Otherwise, consider whether it is reasonable to use the income to offsets short term obligations of 6 to 24 months duration.

"Other" types of income which may be considered as effective income include, but are not limited to:

- pension or other retirement benefits,
- disability income,
- dividends from stocks or other,
- interest from bonds, savings accounts, or others,
- royalties,
- notes receivable, and
- trusts

VA disability income is considered a benefit and does not need to be documented for the likelihood of continuance. A COE will generally have the amount of VA disability income listed, however, see Topic 2, subsection m of this chapter for exceptions.

A VA award letter or bank statement may also verify the current monthly amount received.

The lender may include verified income from public assistance programs in effective income if evidence indicates it will likely continue for 3 years or more.

The lender may include workers' compensation income that will continue for at least 3 years from the anticipated closing date if the borrower chooses to reveal it.

The lender may include verified income received specifically for the care of any foster child(ren), only to balance the expenses of caring for the foster child(ren) against any increased residual requirements.

Example: The borrower(s) receive a stipend paid by the county or State for two foster children living in the residence. Instead of considering a family size of four, a family size of two should be used to determine the residual income requirement.

Do not include temporary income items such as VA educational allowances (including the Post 9/11 GI Bill benefit) and unemployment compensation in effective income.

Exception: If unemployment compensation is a regular part of a borrower's income due to the nature of his/her employment (for example, seasonal work), it may be included.

Continued on next page

Topic 2: Income – Required Documentation and Analysis, continued

r. Other Types of Income, continued

A borrower in receipt of VA Pension or Disability benefits with Aid and Attendance should be discussed with the VA Pension Service, VA Compensation Service, or the VA Hospital where the property is located, to determine if the income is likely to continue for the foreseeable future.

If a borrower has a contract for employment in a foreign country (whether or not the employer is a US company or corporation), the income can be used if it is verified, stable, and reliable. While some contracts are renewed yearly, consider the borrower's past employment history and the likelihood of the contract being extended.

Income that is paid by a foreign employer or government in foreign currency should be converted to US dollars.

Topic 3: Income Taxes and Other Deductions

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Income Tax and Social Security Deductions

Determine the appropriate deductions for Federal income tax and Social Security using the "Employer's Tax Guide", Circular E, issued by the Internal Revenue Service (IRS).

Determine the appropriate deductions for state and local taxes using similar materials provided by the states.

The income tax should be based upon the borrower's residence and what is documented in the guide to the IRS, and not solely the amount claimed on the paystub.

An active-duty servicemember's LES may have a different state tax deduction than the state where the active-duty servicemember will be purchasing a residence or refinancing. Select the state listed on the LES for the state taxes to be considered in state tax deductions.

The lender may consider the borrower's potential tax benefits from obtaining the loan (for example, mortgage interest deduction) in the analysis. To do so:

- determine what the borrower's withholding allowance will be, using the instructions and worksheet portion of IRS Form W-4, Employee's Withholding Allowance Certificate, and
- apply that withholding number when calculating Federal and state income tax deductions on VA Form 26-6393, *Loan Analysis*, then
- document the change in deductions in Item 47, Remarks, on VA Form 26-6393, *Loan Analysis*.

b. Income Tax Credits from Mortgage Credit Certificates (MCC)

MCCs issued by state and local governments may qualify a borrower for a Federal tax credit. The Federal tax credit is based on a certain percentage of the borrower's mortgage interest payment. Lenders must provide a copy of the MCC to VA with the loan package which indicates:

- documentation verifying any expenses charged by the local government entity for the program which is listed on the Closing Disclosure Statement, and

the percentage to be used to calculate the tax credit, and if applicable, the amount of the indebtedness. The certified indebtedness can be comprised of a loan incurred by the borrower to acquire a principal residence or a qualified home improvement rehabilitation loan.

There is an IRS annual limit on the tax credit equal to the lesser of the borrower's maximum tax liability or $2,000. Calculate the tax credit by applying the specified percentage to the interest paid on the certified indebtedness. Then apply the annual limit.

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Topic 3: Income Taxes and Other Deductions, continued

b. Income Tax Credits from Mortgage Credit Certificates (MCC), continued

Example: The MCC shows a 30 percent rate and $100,000 certified indebtedness. The borrower will pay approximately $8,000 in annual mortgage interest. The borrower's estimated total Federal income tax liability is $9,000. Calculate the tax credit as follows:

Table 2: MCC Calculation

Step	Procedure
1	30 percent of $8,000 = $2,400
2	Apply the IRS annual $2,000 limit
3	The tax credit will be $2,000

This allows use of $167 (one twelfth of $2,000) as income to qualify the borrower.

If the mortgage on which the borrower pays interest is greater than the amount of certified indebtedness, limit the interest used in the tax credit calculation to that portion attributable to the certified indebtedness.

Since these programs are offered by state and local government(s), pre- approval by VA is not required for the borrower to participate in the program. The lender is responsible to determine all eligibility requirements are met by the borrower to participate in the program.

c. Other Deductions from Income

Include any costs for job-related expenses, child care, significant commuting costs, and any other direct or incidental costs associated with the borrower's or spouse's employment.

For children up to the age of 12 years, the lender is responsible for determining if there are any child care expenses for the borrower(s).

Topic 4: Assets and Closing Requirements

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Assets and Amount of Cash Required for Closing

The borrower(s) must have sufficient cash assets to cover:

- any closing costs, pre-paids, or discount points which are the borrower's responsibility and are not financed into the loan, and
- the difference between the sales price and the loan amount, if the sales price exceeds the reasonable value established by VA (i.e. negative equity).

VA does **not** require the borrower(s) to have additional cash to cover a certain number of mortgage payments, unplanned expenses or other contingencies on the residence, or refinance of the Veteran's residence.

However, the borrower's ability to accumulate liquid assets and the current availability of liquid assets for unplanned expenses should be considered in the overall credit analysis.

Reserves are required for borrowers using rental income to qualify. See Topic 2, subsection n of this chapter for more information.

A rental offset does not require additional assets to cover PITI. See Topic 2, subsection n of this chapter for more information.

The assets securing a loan(s) against deposited funds (signature loans, cash value life insurance policies, 401(k) loans, other) may not be included as an asset on the VA Form 26-6393, Loan Analysis. See Topic 5 of this chapter for more information.

b. Verification of Assets and Cash to Close Requirements

Verify all liquid assets owned by the borrower(s) to the extent they are needed to close the loan. In addition, verify any liquid assets that may have a bearing on the overall credit analysis (significant assets). Use VA Form 26-8497a, Request for Verification of Deposit, or electronic, or certified copies of the borrower's last two bank statements.

Verifications must be no more 120 days old (180 days for new construction).

For automatically closed loans, this means the date of the deposit verification is within 120 days of the date the note is signed (180 days for new construction).

For prior approval loans, this means the date of the deposit verification is within 120 days of the date the application is received by VA (180 days for new construction).

Continued on next page

Topic 4: Assets and Closing Requirements, continued

c. Pending Sale of Real Estate

In some cases, the determination that the income and/or assets of borrowers are needed to qualify for the loan depends upon the sale of presently the borrower's owned real property.

The sale proceeds may be necessary to:

- clear the outstanding mortgage(s) against the property,
- pay outstanding consumer obligations,
- make a downpayment or pay closing costs on the VA loan, and/or
- restore previously used VA entitlement.

Evidence the sale has been completed should be included in the closing package to verify proceeds from the sale.

As an alternative, the Veteran may sell the property with the buyer assuming the outstanding mortgage obligation. See Chapter 6 of this handbook for assumptions (Release of Liability) with a Substitution of Entitlement to restore previously used entitlement.

See Chapter 5 of this handbook for prior approval loans, which depend upon the sale of property for the borrower to qualify.

See Chapter 5 of this handbook for all required loan closing documents.

d. Gift Funds

A gift can be provided by a donor that does not have any affiliation with the builder, developer, real estate agent, or any other interested party to the transaction. A gift letter must:

- specify the dollar amount of the gift,
- include the donor's statement that no repayment is expected, and
- indicate the donor's name, address, telephone number, and relationship to the borrower.

The lender must verify that sufficient funds to cover the gift have been transferred to the borrower's account, or will be documented as received by the closing agent at the time of closing.

Acceptable documentation includes the following:

- evidence of the borrower's deposit,
- a copy of the donor's funds by check/electronic transfer to the closing agent, or
- the CD showing receipt of the donor's funds.

Topic 5: Debts and Obligations

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Verification Requirements for Debts and Obligations

All debts and obligations of the borrowers' must be verified and rated. Obtain a credit report with all information for all credit bureaus. See Topic 7, subsection a of this chapter for details on the type of credit report required.

For obligations not included on the credit report which are revealed on the application or through other means, the lender must obtain a verification of payment history showing the obligation or other written verification directly from the creditor, including the payment amount and outstanding balance.

The lender must also separately verify accounts listed as "will rate by mail only" or "need written authorization."

When a pay stub(s) or LES indicates an allotment, the lender must investigate the nature of the allotment to determine whether the allotment is related to a debt or other obligation(s). Examples may include 401K obligation or repayment, child care, child support, or other.

For obligations that have not been rated on the credit report or elsewhere, obtain the verification and rating directly from the creditor. Include a written explanation for any obligation that is not rated.

Resolve all discrepancies prior to closing. If the credit report, deposit verification, bank statement, or pay stub(s) reveals any debts or obligations which were not divulged by the borrowers):

- obtain clarification as to the status of such debts from the borrower(s), then
- verify any remaining discrepancies with the creditor.

Credit reports and verifications must be no more than 120 days old (180 days for new construction).

For automatically closed loans, this means the date of the credit report or verification is within 120 days of the date the note is signed (180 days for new construction).

For prior approval loans, this means the date of the credit report or verification is within 120 days of the date the application is received by VA (180 days for new construction).

ECOA prohibits requests for, or consideration of, credit history and liability information of a spouse who will not be contractually obligated on the loan, except:

- if the borrower(s) is relying on alimony, child support, or maintenance payments from the spouse (or former spouse), or
- in community property states.

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Topic 5: Debts and Obligations, continued

a. Verification Requirements for Debts and Obligations, continued

If either of these situations is applicable, the lender must:

- Obtain a credit report on the non-purchasing spouse in addition to the Veteran's credit report.
- Consider the spouse's credit history in reaching a determination. A Veteran borrower with a satisfactory credit history may be considered a satisfactory risk even though the non-purchasing spouse's credit may be unsatisfactory.
- Include the monthly payment of the non-purchasing spouse's debts on the VA Form 26-6393, Loan Analysis. For debts such as judgments and unpaid collection accounts, lenders should consider the Veteran's capacity to address the debt(s).
- Develop the facts surrounding any unsatisfied judgments on the spouse's credit report, such as where the judgment was filed and whether the parties were married to one another at the time, and secure a competent legal opinion whether the judgment may become a lien against the property.
- Exclude the monthly payment on the spouse's debts from the loan analysis when a reliable source of income for the spouse is verified to reach such a conclusion which is voluntarily provided.
- Document VA Form 26-6393, Loan Analysis, with an explanation of facts and determination when concluding credit worthiness of the Veteran or excluding obligations of the non-purchasing spouse.

b. Verification of Alimony and Child Support Obligations

The payment amount of any alimony and/or child support obligation of the borrower must be verified.

Do not request documentation of a borrower's divorce unless it is necessary to verify the amount of any alimony or child support liability indicated by the borrower. 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, they should make any inquiries necessary to resolve discrepancies and obtain the appropriate verification.

Spousal support may be treated as a reduction in income on VA Form 26-6393, Loan Analysis.

Child support payment is treated as a liability on VA Form 26-6393, Loan Analysis.

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Topic 5: Debts and Obligations, continued

c. Analysis of Debts and Obligations

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 of 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 or lease with a remaining balance of $1,500, even though it should be paid out in 5 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 borrower's ability to provide for family living expenses.

If a married Veteran wants to obtain the loan in his or her name only, the Veteran may do so without regard to the spouse's debts and obligations in a non-community property state. However, in community property states, the spouse's debts and obligations must be considered even if the Veteran wishes to obtain the loan in his or her name only. See Topic 2, subsection c of this chapter.

Debts assigned to an ex-spouse by a divorce decree will not generally be charged against a borrower. This includes debts that are now delinquent.

d. Borrower as Co-obligor/Co-Signor on a Loan or Obligation

The borrower(s) may have a contingent liability based on co-signing a loan. The lender may exclude the loan payments from the monthly obligations factored into the net effective income calculation in the loan analysis if:

- there is evidence that the loan payments are being made by someone else and the obligation is current, and
- there is not a reason to believe that the borrower will have to participate in repayment of the loan.

e. Pending Sale of Real Estate

A borrower(s) may have a current home and the sale of the real property is needed to complete the transaction. 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. See Topic 4, subsection c of this chapter for necessary documents.

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Topic 5: Debts and Obligations, continued

f. Secondary Borrowing

If the borrower(s) plans to obtain a second mortgage simultaneously with the VA-guaranteed loan, include the second mortgage payment as a significant debt. From an underwriting standpoint, the Veteran must not be placed in a substantially worse position than if the entire amount borrowed had been guaranteed by VA. See Chapter 9 of this handbook for VA limitations on secondary borrowing.

If the borrower(s) provides written evidence that the student loan debt will be deferred at least 12 months beyond the date of closing, a monthly payment does not need to be considered.

If a student loan is in repayment, or scheduled to begin within 12 months from the date of VA loan closing, the lender must consider the anticipated monthly obligation in the loan analysis and utilize the payment established by calculating each loan at a rate of five percent of the outstanding balance divided by 12 months.

Example: A borrower has a $25,000 student loan balance and you multiple it by 5%, which equals $1,250. This amount ($1,250) is divided by 12 months to equal a monthly payment of $104.17.

If the payment(s) reported on the credit report for each student loan(s) is greater than the threshold payment calculation above in a above, the lender **must** use the payment recorded on the credit report.

If the payment(s) reported on the credit report is less than the threshold payment calculation above, in order to count the lower payment, the loan file must contain a statement from the student loan servicer that reflects the actual loan terms and payment information for each student loan(s).

The statement(s) must be dated within 60 days of VA loan closing, and may be an electronic copy from the student loan servicer’s website or a printed statement provided by the student loan servicer.

It is the lender’s discretion as to whether the credit report should be supplemented with this information.

g. Loans Secured by Deposited Funds

Certain types of loans secured against deposited funds (signature loans, cash value life insurance policies, 401(k) loans, or other) in which repayment may be obtained through extinguishing the asset, do not require repayment consideration for loan qualification.

The assets required to secure a loan(s) may not be included as an asset on the VA Form 26-6393, *Loan Analysis*.

Use the current balance times 60 percent minus the loan balance to equal the usable amount to consider as an asset.

A statement would only be necessary to verify the amount used as an asset.

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h. Open 30-Day Charge Accounts

An open 30-day charge account is defined as an account in which the borrower(s) must pay off the outstanding balance on the account every month.

For open 30-day charge accounts, determine if the borrower(s) pays the balance in full each month, and has verified funds to cover the account balance in addition to any funds required for closing costs.

- If there are sufficient funds, the payment does not need to be included in Section D of the VA Form 26-6393, Loan Analysis, but the obligation should continue to be listed.
- If there are not sufficient funds, a minimum payment of 5 percent of the balance should be considered included in Section D of the VA Form 26-6393, Loan Analysis.

Topic 6: Debts Owed to the Federal Government

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Title Search Requirements

The lender is responsible for obtaining the necessary title search to ensure there are no encumbrances that would preclude the borrower from obtaining a loan.

b. VA Form 26-8937, Verification of Benefits

The lender is responsible for obtaining the necessary title search to ensure there are no encumbrances that would preclude the borrower from obtaining a loan.

Generally, VA Form 26-8937, Verification of VA Benefits, is not needed unless the COE or new IRRRL case number indicates to submit the form to VA before closing. However, ask the Veteran and any Veteran co-obligors (including spouse if a Veteran) if he or she:

- will be discharging within the next 6 months from the military and has completed a PEB or MEB and will be filing for VA disability while still on active duty,
- has recently filed for VA disability and compensation, or VA pension, and VA has not yet made a determination,
- would be entitled to receive VA disability benefits, but in receipt of retirement pay,
- has received VA disability benefits in the past, or
- is an unmarried surviving spouse of a Veteran (has applied and/or in receipt of DIC who died on active duty or as a result of a
- service-connected disability.

If the Veteran falls under one of the above categories, follow the procedures discussed in Topic 2, subsection m of this chapter.

When VA returns the form to the lender and the form indicates that the borrower has any of the following:

- an outstanding indebtedness of VA overpaid education, compensation, or pension benefits,
- an education or direct home loan in default,
- an outstanding indebtedness resulting from payment of a claim on a prior VA home loan, or
- a repayment plan for any of these debts that is current,

Then one of the following must accompany the loan package:

- evidence of payment in full of the debt, or
- evidence of a current payment plan acceptable to VA and evidence that the Veteran executed a promissory note for the entire debt balance.

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Topic 6: Debts Owed to the Federal Government, continued

b. VA Form 26-8937, Verification of Benefits, continued

VA may find a repayment plan acceptable if:

- the Veteran has been satisfactorily making payments on a repayment plan in effect prior to the lender's inquiry,
- the Veteran's overall credit history and anticipated financial capacity after the proposed loan is made indicate a reasonable likelihood that the repayment plan will be honored and the outstanding amount of indebtedness is not so large that it would prevent payment in full, within a reasonable period (approximately 1 year), or
- the case involves unusually meritorious circumstances.

Examples

Consideration would be given to a Veteran with an outstanding/excellent credit history and adequate income whose debt balance is too large to be reasonably paid out in less than 18 months to 2 years.

VA will offer special consideration to a Veteran's claim that he or she was not previously aware of an overpayment of benefits.

c. What is the Credit Alert Verification Reporting System (CAIVRS)

CAIVRS is a Department of Housing and Urban Development (HUD) maintained computer information system which enables participating lenders to learn when a borrower has previously defaulted on a federally-assisted loan. More information can be found at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/caivrs

The database includes default information from the Department of Agriculture, Department of Education, Department of Justice, HUD, Small Business Administration, Federal Deposit Insurance Corporation, and VA.

The VA default information included in the database relates to:

- overpayments on education cases,
- overpayments on disability benefits income, and
- claims paid due to home loan foreclosures which resulted in a debt of the government (Generally type 2 VA loans).

CAIVRS Procedures

A CAIVRS inquiry must be performed for all borrowers and co-borrowers (Veteran or non-Veteran) on all VA loans, including IRRRLs. The one exception to this policy is that CAIVRS is not required for non-purchasing spouses in community property states.

VA assigns a 10-digit VA lender identification number (ID) to each new lender, then automatically forwards the ID number to HUD with a request to grant the lender CAIVRS access. The lender can begin accessing CAIVRS usually between 7 to 10 business days after receiving its VA ID number assignment.

Continued on next page

Topic 6: Debts Owed to the Federal Government, continued

c. What is the Credit Alert Verification Reporting System (CAIVRS), continued

To register for CAIVRS access for first time users, please use the following link: https://entp.hud.gov/idapp/html/f57register.cfm.

Please direct questions concerning problems encountered with accessing CAIVRS to caivrs_admin@hud.gov.

If the borrower(s) is found to have a delinquent federal debt through CAIVRS, the validity and delinquency status of the debt should be verified by contacting the creditor agency using the contact phone number and case number reflected on the borrower's CAIVRS report.

The creditor agency that is owed the debt can verify that the debt has been resolved. Documentation should be included in the loan file and an explanation must be provided on VA Form 26-6393, *Loan Analysis*. It is not necessary for CAIVRS to update the number if documentation is included in the loan file.

Once screening is complete, enter the CAIVRS confirmation code on VA Form 26-6393, *Loan Analysis*, in the space to the right of the "no" block in item 46 for purchase and refinances.

For IRRRLs, enter the code on VA Form 26-8923, *IRRRL Worksheet,* in the Notes section.

d. Borrower with Presently Delinquent Federal Debts

When CAIVRS or another source indicates that the borrower has a delinquent Federal debt, the following steps must be taken:

- Suspend processing of the loan application to determine the reason for the non "A" number.
- Give full consideration to the CAIVRS information, and any subsequent clarifying information or documentation provided, in applying VA credit standards. Any non "A" number received does not automatically disqualify a Veteran from using their home loan benefit; however, the lender must document and justify the approval. See Topic 7, subsection b of this chapter for documentation and explanation requirements.
- If a previous VA loan is involved that resulted in a debt to the government (due to foreclosures, short sale, deed in lieu, or other), the borrower may contact the VA Debt Management Center at 1-800-827- 0648 or at dmc.ops@va.gov to make arrangements to repay the debt.

Generally, only type 2 VA loans (fifth digit of the VA loan number) result in a debt to VA and are reported. The Veteran's entitlement cannot be restored until the debt to VA is paid in full.

If the fifth digit of the previous loan number is a type 6 VA loan, there is generally a loss to the government and the loss is not reported to CAVIRS. A loss to VA does not need to be repaid; however, the Veteran's previously used entitlement to guaranty the previous VA loan is not restored until the loss is paid in full.

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Topic 6: Debts Owed to the Federal Government, continued

d. Borrower with Presently Delinquent Federal Debts, continued

Each agency has their timeliness requirements before removing a non “A” CAVIRS finding. This does not preclude the Veteran or borrower from receiving a VA loan if credit standards are met for VA loans. See Topic 4.07b (13 and 14) of this Chapter for guidelines after a bankruptcy or foreclosure.

Example: A borrower suffered a loss on a FHA loan home loan 2 years ago. While HUD has not removed the CAIVRS finding as the 3-year waiting period has not passed for FHA, the lender is eligible to continue processing a VA loan without an “A” CAIVRS finding due to the borrower(s) meeting VA credit guidelines for foreclosures and documented in the loan file.

CAIVRS information is only for the lender’s and borrower’s use in processing the loan application. Only those persons having responsibility for screening borrowers and/or co-borrowers may use CAIVRS. Any other use is unauthorized.

e. Treatment of Federal Debts

A borrower(s) 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 arrangement have been made between the borrower and the Federal agency.

Example: A borrower has delinquent taxes and payments have not been made for several years. The establishment of a payment plan after the CAVIRS finding has been addressed may not be sufficient to show a satisfactory payment arrangement to repay the obligation.

A borrower(s) 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.

Topic 7: Credit History – Required Documentation and Analysis

Change Date: July 27, 2023

- Subsection b has been updated to include guidance regarding medical collections and medical charge offs.
- Subsection b has been updated to provide clarity regarding the monthly payment consideration for unpaid medical collection accounts.

a. Credit Report Standards

Credit Reports used in analyzing VA loans must be either Three-file Merged Credit Reports (MCR), or Residential Mortgage Credit Reports (RMCR).

The credit report must be less than 120-days old (180 days for new construction). For automatically closed loans and prior approval loans, the date of the credit report must be within 120 days of the date the note is signed (180 days for new construction).

If an RMCR is used, the standards applicable to a RMCR include, but are not limited to, the following:

- The report must be prepared by a reputable credit reporting agency.
- Each account with a balance must have been checked with the creditor within 90 days of the date of the credit report.

For each debt listed, the report must provide the creditor's name, date the account was opened, high credit, current status, required payment, unpaid balance, and payment history.

The report must name at least two national repositories of credit records contacted for each location in which the borrower has resided during the most recent 2 years (separate repository inquiries are required for any co-borrowers with individual credit records).

The report must include all available public records information that is not considered obsolete under the Fair Credit Reporting Act (15 U.S.C. § 1681) such as bankruptcies, judgments, law suits, foreclosures and tax liens.

The RMCR must be an original or electronic report, with no erasures, whiteouts, or alterations.

The report must contain a 24-month employment and residency history.

VA may decline to accept a credit report which does not meet these standards.

If possible, the cost of the credit report must be listed on the credit report. If not possible, an itemized invoice identifying the borrower(s) is required to verify the cost on the Closing Disclosure Statement (CD) when charging the borrower for the credit report.

Continued on next page

Topic 7: Credit History – Required Documentation and Analysis, continued

b. How to Analyze Credit

The borrower's past repayment practices on obligations is the best indicator of his or her willingness to repay future obligations. Emphasis should be on the borrower's overall payment patterns rather than isolated occurrences of unsatisfactory repayment. Determine whether the borrower (and spouse, if applicable) is a satisfactory credit risk based on a careful analysis of the credit report and other credit data.

VA does not have a minimum credit score requirement.

Rent and Mortgage Payment History

The borrower's most recent 24-month rental history and any outstanding, assumed, or recently retired mortgages must be verified and rated. Housing expense payment history is often a primary indicator of how motivated the borrower is to make timely mortgage payments in the future.

Absence of Credit History

For borrower(s) with no established credit history, base the determination on the borrower's payment record on alternative or nontraditional credit directly from the borrower or creditor in which a payment history can be verified.

Absence of a credit history is not generally considered an adverse factor.

It may result when:

- borrower(s) has not yet developed a credit history,
- borrower(s) has routinely used cash rather than credit, and/or
- borrower(s) has not used since some disruptive credit event such as bankruptcy or debt pro-ration through consumer credit counseling.

Accounts in the Spouse's Name

See Topic 2, subsection c in this chapter for ECOA and consideration of the spouse's credit history.

Adverse Credit Data

In circumstances not involving bankruptcy, satisfactory credit is generally considered to be re-established after the borrower(s), have made satisfactory payments for 12 months after the date the last derogatory credit item was satisfied. If a credit report reveals numerous unpaid collections and/or accounts that are not being paid timely, including some which have been outstanding for many years, then once the borrower has satisfied the obligations, and then makes timely payments on subsequent obligations for at least 12 months, satisfactory credit is considered re-established.

Continued on next page

Topic 7: Credit History – Required Documentation and Analysis, continued

b. How to Analyze Credit, continued

Medical Collection and Charge-off Accounts

Identifiable medical collections are collection accounts that are established when an overdue medical bill is referred to a collection agency. Charge-offs may occur when a creditor is no longer pursuing repayment of the medical debt. Lenders may disregard all identifiable medical collections, including charge-off accounts, that have not been reduced to a judgment or lien.

Identifiable medical collection accounts that have not been reduced to a judgment or lien do not have to be paid off as a condition for loan approval and should not impact the overall acceptability of a borrower's credit.

Lenders do not need to obtain explanations for medical collections or charge-offs and do not need to otherwise address such accounts.

Non-medical Collection Accounts

Isolated non-medical collection accounts do not necessarily have to be paid off as a condition for loan approval. A credit report may show numerous satisfactory accounts and one or two unpaid collections. In such instances, while it would be preferable to have collections paid, it would not necessarily be a requirement for loan approval.

However, non-medical collection accounts must be considered part of the borrower’s overall credit history and such accounts should be considered open, recent credit. These unpaid accounts must therefore be considered in the debt-to- income ratio and residual income calculation on VA Form 26-6393, Loan Analysis, and when using an Automated Underwriting System (AUS). If such accounts are listed on the credit report with a minimum payment, then the debt should be recognized at the minimum payment amount.

Non-medical collection accounts without established payment arrangements are to be included with a calculated monthly payment using 5% of the outstanding balance of the collection. Borrowers with a history of such accounts should have re-established satisfactory credit in order to be considered a satisfactory credit risk.

While VA does not require such accounts be paid-off prior to closing if the borrower’s overall credit is acceptable, an underwriter must address the existence of the account(s) with an explanation on VA Form 26- 6393, Loan Analysis, and justify why positive factors outweigh the negative credit history such accounts represent.

Charge -off Accounts

These accounts are typically collections in which the creditor is no longer pursuing collection of the account. The underwriter must address the circumstances regarding the negative credit history when reviewing the overall credit of the borrower(s). This does not apply to identifiable medical charge-offs, as described above.

Continued on next page

Topic 7: Credit History – Required Documentation and Analysis, continued

b. How to Analyze Credit, continued

Disputed Accounts

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.

The underwriter should document the reason(s) for not considering an account on VA Form 26-6393, *Loan Analysis*.

Judgments

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.

A history of timely payments would be generally considered as making 12 payments to reestablish credit.

However, in certain cases when a judgment has only been in place for a few months, an underwriter could justify on VA Form 26-6393, *Loan Analysis*, a shorter repayment history if the documentation indicates the borrower immediately addressed the judgment after it was filed and began a repayment plan.

Payoff of Unpaid or Untimely Debts

For unpaid or debts that have not been paid timely, pay-off of these debts after the acceptability of a borrower's credit is questioned does not alter the unsatisfactory record of payment. A period of making timely payments on subsequent obligations for at least 12 months, then satisfactory credit is considered re-established.

Consumer Credit Counseling Plan

If a borrower(s) has 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 borrower(s) has 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 borrower entered the Consumer Credit Counseling plan before reaching the point of having bad credit.

Bankruptcy

The fact that a bankruptcy exists in a borrower (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.

Continued on next page

Topic 7: Credit History – Required Documentation and Analysis, continued

b. How to Analyze Credit, continued

Bankruptcy Filed Under the Straight Liquidation and Discharge Provisions of the Bankruptcy Law (Petition under Chapter 7 of the Bankruptcy Code):

- If the bankruptcy was discharged more than 2 years ago from the date of closing for purchases and refinances, it may be disregarded.
- If the bankruptcy was discharged within the last 1 to 2 years, it is probably not possible to determine that the borrower or spouse is a satisfactory credit risk unless both of the following requirements are met:

Table 3: Requirements for Bankruptcies Discharged within the last 1 to 2 years

Requirement	Explanation
1	The borrower(s) had obtained consumer items on credit subsequent to the bankruptcy and has satisfactorily made the payments over a continued period.
2	The bankruptcy was caused by circumstances beyond the control of the borrower 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 discharged within the past 12 months, it will generally not be possible to determine that the borrower(s) is a satisfactory credit risk.

If the bankruptcy was caused by failure of the business of a self-employed borrower, it may be possible to determine that the borrower is a satisfactory credit risk if all four of the following are met:

Table 4: Requirements for Bankruptcies Caused by the Failure of a Self-Employed Borrower's Business

Requirement	Explanation
1	The borrower obtained a permanent position after the business failed.
2	There is not any derogatory credit information prior to the self-employment.
3	There is not any derogatory credit information subsequent to the bankruptcy.
4	Failure of the business was not due to the borrower's misconduct.

Continued on next page

b. How to Analyze Credit, continued

Bankruptcy 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 2 to 3-year period or, in some cases, up to 5 years, to pay off scaled down or entire debts.

If the borrower(s) has finished making all payments satisfactorily, the lender may conclude that the borrower has re-established satisfactory credit.

If the borrowers) 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 or short sale in lieu of foreclosure) exists in a borrower(s) history does not in itself disqualify the loan. Develop complete information on the facts and circumstances of the foreclosure.

You may disregard a foreclosure finalized more than 2 years from the date of closing. If the foreclosure was finalized within the last 1 to 2 years from the date of closing, it is probably not possible to determine that the borrower(s) is a satisfactory credit risk unless both of the following requirements are met:

The borrower (s) has obtained consumer items on credit subsequent to the foreclosure and has satisfactorily made the payments over a continued period, and

The foreclosure was caused by circumstances beyond the control of the borrower (s) such as unemployment; prolonged strikes, medical bills not covered by insurance, and so on, and the circumstances are verified.

If a foreclosure, deed in lieu, or short sale process is in conjunction with a bankruptcy, use the latest date of either the discharge of the bankruptcy or transfer of title for the home to establish the beginning date of re-established credit. If there is a significant delay in the transfer of title, the lender should contact the RLC of jurisdiction for guidance.

Deed in lieu or short sale

For a deed in lieu or short sale, develop complete information on the facts and circumstances in which the borrowers) voluntarily surrendered the property. If the borrower's payment history on the property was not affected before the short sale or deed in lieu and was voluntarily communicating with the servicer or holder, then a waiting period from the date transfer of the property may not be necessary.

If the foreclosure, deed and lieu or short sale was on a VA-guaranteed loan, then a borrower may not have full entitlement available for the new VA loan. Ensure that the borrower's COE reflects sufficient entitlement to meet any secondary marketing requirements of the lender.

Topic 8: Automated Underwriting Cases (AUS)

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. General AUS Information

VA has approved Freddie Mac's Loan Prospector, Fannie Mae's Desktop Underwriter, and VA approved proprietary lender AUS systems to use in connection with VA-guaranteed home loans. These systems incorporate VA's credit standards and processing requirements.

Lenders may use certain reduced documentation requirements on cases processed with approved AUS. The level of reduced documentation depends on the risk classification assigned. The systems use different terminology such as Approve or Accept. The tables in this section give a general description of documentation waivers. Please note that the documentation requirements are the same for these cases as for non-AUS cases, except for any differences cited in the tables.

The automated systems do not approve or disapprove loans. They merely determine a risk classification. It is still the lenders underwriter's decision whether or not to approve the loan.

Although VA has approved the use of these systems, we are not the vendor. The terms and conditions of use must be negotiated directly with the provider of these systems.

It is imperative that the data entered into the automated underwriting system be accurately verified. The data utilized by the system must be supported by source documentation obtained by the lender. Inaccurate or unverified data will result in invalidation of the risk classification. Under certain circumstances, it could also result in a finding of material misrepresentation, which could affect the validity of the guaranty.

b. Underwriter's Certification

Because the AUS will be making the determination that the loan satisfies credit and income requirements, cases receiving an "Accept" or "Approve" rating will not require the underwriter's signature on VA Form 26-6393, Loan Analysis (items 49 through 53). However, the file must still contain the Lender's Certification referenced in Chapter 5 of the VA Lender's Handbook.

Continued on next page

Topic 8: Automated Underwriting Cases (AUS), continued

c. Documentation Guidelines for Credit History

Refer to the following table for documentation guidelines for credit history:

Table 5: Documentation Guidelines for Credit History

Subject and Reference	Documentation Guidelines and Reductions for Refer	Documentation Reductions for Accept/Approve
Types of credit reports used in reconciliation (Topic 7 of this chapter)	Use any of the following if ≤120 or 180-days old (existing/new constructions): All in-file reports, Selected in-file reports, Merged credit report, or RMCR	Same as Refer.
Explanation of discrepancies in reported debt (Topic 5 of this chapter)	No explanation is required.	Same as Refer.
Rental payment history (Topic 7 of this chapter)	Provide a 24 month rental history directly from the landlord, through information shown on credit report or by cancelled checks	No verification of rent is required.
Verification of significant non-mortgage debt (Topic 5 of this chapter)	Obtain direct verification for significant debts not reported on the credit report. **Note:** Significant means that the debt has a monthly payment exceeding 2 percent of the stable monthly income for all borrowers.	Same as Refer. **Note**: Perform manual downgrade to Refer if direct verification reveals more than 1 by 30 day late payment in the past 12 months for any of the omitted debts.

Continued on next page

Topic 8: Automated Underwriting Cases (AUS), continued

c. Documentation Guidelines for Credit History, continued

Table 5: Documentation Guidelines for Credit History, continued

Subject and Reference	**Documentation Guidelines and Reductions for Refer**	**Documentation Reductions for Accept/Approve**
Mortgage payment history (Topic 7 of this chapter)	Obtain direct verification when ratings are not available on mortgages that are any of the following: • Outstanding, • Assumed, or • Recently retired. A written explanation of mortgage payment history is required for borrowers with more than 1 by 30 day late payment for all mortgages for the past 12 months.	Perform manual downgrade to Refer for any mortgage debt with more than 1 by 30 day late payment in the past 12 months.
Account balances (Topic 7 of this chapter)	If a mortgage or other significant debt is listed on the credit report as past due and was last updated ≥90 days, verify current status of past due debt.	Same as Refer, however if rating is currently ≥90 days past due, manually downgrade to **Refer.**
Derogatory credit information (Topic 7 of this chapter)	Obtain explanation for derogatory credit. Explain assessment of creditworthiness on *VA Form 26-6393,* Loan *Analysis*	No determination of creditworthiness is required.
Alimony and/or child support payments (Topic 2 of this chapter)	Provide the following: • Proof of deposits on bank statements for 3 months, and • Front page and details of support payments from the divorce decree, indicating evidence of at least 3 years continuance.	Same as Refer.

Continued on next page

Topic 8: Automated Underwriting Cases (AUS), continued

d. Documentation Guidelines for Borrower(s) Not Self-Employed

Refer to the following table for documentation guidelines for employment/income for borrower(s) who are ***not*** self-employed:

Table 6: Documentation Guidelines for Borrower(s) Not Self-Employed

Subject and Reference	Documentation Guidelines and Reductions for Refer	Documentation Reductions for Accept/Approve
Employment gaps (Topic 2 of this chapter)	No explanation for employment gaps is required if the gaps are <30 days.	No explanation for employment gaps is required if gaps are <60 days.
Verifying current employment for borrowers who are not self-employed (Topic 2 of this chapter)	Document telephone contact verifying borrower’s current employer. Use pay stubs covering at least 1 full month of employment and contains the following: • Year-to-Date (YTD) information, • Bonus information, and • Overtime information.	Same as Refer.

Continued on next page

Topic 8: Automated Underwriting Cases (AUS), continued

d. Documentation Guidelines for Borrower(s) Not Self-Employed, continued

Table 6: Documentation Guidelines for Borrower(s) Not Self-Employed, continued

Subject and Reference	**Documentation Guidelines and Reductions for Refer**	**Documentation Reductions for Accept/Approve**
Verifying previous employment (Topic 2 of this chapter)	Use a VOE or any of the following, covering the 2-year period prior to closing: • W-2 Forms, or • Income information obtained from the IRS via one of the following forms: ☐ Form 8821, Tax Information Authorization, (or alternate form acceptable to the IRS that collects comparable information) or ☐ Form 4506, Request for Copy of Tax Return, (or alternate form acceptable to the IRS that collects comparable information). • No VOE or W-2 Forms are required for a borrower on active duty. • The Leave and Earning Statement (LES) should be used.	No VOE is required if the borrower has been with the same employer for 1 year and W-2 Forms for 1 previous year have been collected. No W-2 Forms are required for a borrower on active duty. No W-2 Forms are required if all of the following are met: • Borrower is with the same employer >2 years • Employer phone contact verifies the length of employment and current status (still employed) • Borrower is not self-employed or commissioned • Bonus, overtime, or secondary income is not needed to qualify • Stable monthly income is to be determined by using current base pay only (rather than total earnings) • Borrower signs one of the following for the previous 2 tax years: ☐ Form 8821, and ☐ Form 4506.

Continued on next page

Topic 8: Automated Underwriting Cases (AUS), continued

e. Documentation Guidelines for Borrower(s) Self-Employed

Refer to the following table for documentation guidelines for employment/income for borrower(s) who are self-employed:

Table 7: Documentation Guidelines for Borrower(s) who are Self-Employed

Subject and Reference	Documentation Guidelines and Reductions for Refer	Documentation Reductions for Accept/Approve
Individual tax returns for self- employed borrowers (Topic 2 of this chapter)	Provide one of the following, with all line items captured: • signed copies of individual tax returns for the most recent 2- year period or tax transcripts, or • individual income information obtained from the IRS via one of the following forms: ☐ Form 8821 (or an alternate form acceptable to the IRS that collects comparable information) or ☐ Form 4506 (or an alternate form acceptable to the IRS that collects comparable information).	Same as Refer.
Balance sheets and profit and loss statements for self-employed borrowers (Topic 2 of this chapter).	No balance sheet or YTD Profit and Loss (YTD P&L) is required if origination date is < 7 months from the business' fiscal year end (for which tax returns or information from the IRS via Form 8821 or Form 4506 were provided).	No balance sheet or YTD P&L is required.

Continued on next page

Topic 8: Automated Underwriting Cases (AUS), continued

e. Documentation Guidelines for Borrower(s) Self-Employed, continued

Table 7: Documentation Guidelines for Borrower(s) who are Self-Employed, continued

Subject and Reference	**Documentation Guidelines and Reductions for Refer**	**Documentation Reductions for Accept/Approve**
Business tax returns for self-employed borrowers (Topic 2 of this chapter)	Provide one of the following, with all line items captured: • Signed copies of business tax returns for the most recent 2-year period. • Business income information obtained from the IRS via one of the following forms: ☐ Form 8821 (or an alternate form acceptable to the IRS that collects comparable information) or ☐ Form 4506 (or an alternate form acceptable to the IRS that collects comparable information).	No business tax returns are required if all of the following conditions are met: • Borrower proves ownership of the business for at least the past 5 years. • Individual tax returns reflect consistent income for the past 2 years. • Funds for downpayment or closing costs are not from the business.
Verify assets to close in the borrower's name (Topic 4 of this chapter)	Provide bank/asset statements covering the most recent 2-month period in lieu of a Verification of Deposit (VOD).	Provide bank/asset statements covering most recent 1- month period in lieu of a VOD.

Topic 9: How to Complete VA Form 26-6393 Loan Analysis

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. General

In order to properly enter information on VA Form 26-6393, *Loan Analysis*, the underwriter must understand and apply the guidelines provided in the preceding sections of this chapter.

b. Estimated Monthly Shelter Expense

Special instructions are listed in the following table:

Table 8: Estimated Monthly Shelter Expenses

Item	Special Instructions
16	If taxes are expected to increase, use the increased amount.
17	Include the flood insurance premium for properties located in special flood hazard areas.
18	If special assessments are anticipated, use the anticipated amount.
19	Calculate maintenance and utility costs using 14¢ per square foot for the gross living area as per the appraisal. **Example**: A 1,500 square foot home with a 1,500 square foot unfished basement would have a combined maintenance and utility cost of $210 (1,500sq X .14).
20	For condominiums or houses in a Planned Unit Development (PUD), include the monthly amount of maintenance assessment payable to the homeowner's association.

c. Debts and Obligations

List all known debts and obligations of the borrower and spouse including any alimony and/or child support payments. Spousal support or alimony may be treated as a reduction in income; however, child support is to be treated as a liability.

Place a check mark in the (3) column next to any "significant" debt or obligation. See the topic "Analysis of Debts and Obligations" in Topic 4.05c of this chapter, for an explanation of "significant."

<u>Job Related Expense – Section D line 29</u>.

Include any costs for child care, significant commuting costs, and any other direct or incidental costs associated with the borrower's (or spouse's) employment. Check this item if total job-related expenses are significant.

Up to age 12, the lender is responsible for determining if there are any child care expenses for the borrower(s).

Continued on next page

Topic 9: How to Complete VA Form 26-6393, Loan Analysis, continued

d. Federal Income Tax – Item 32

Enter the borrower's estimated monthly Federal income tax, based upon IRS tax tables. If the borrower has a MCC, reduce the Federal income tax by the estimated tax credit. See Topic 3, subsection b of this chapter for MCC.

e. Balance Available for Family Support – Item 43

Enter the appropriate residual income amount from the following tables in the "guideline" box. Residual income is the amount of net income remaining (after deduction of debts and obligations and monthly shelter expenses) to cover family living expenses.

The numbers are based on data supplied in the Consumer Expenditures Survey (CES) published by the Department of Labor's Bureau of Labor Statistics.

They vary according to loan size, family size, and region of the country.

Residual Tables. A key to the geographic regions is listed in the following tables:

Table 9: Table of Residual Incomes by Region for Loan Amounts of $79,999 and Below

Family Size	Northeast	Midwest	South	West
1	$390	$382	$382	$425
2	$654	$641	$641	$713
3	$788	$772	$772	$859
4	$888	$868	$868	$967
5	$921	$902	$902	$1,004

For Family Size Over 5: Add $75 for each additional member up to a family of seven.

Table 10: Table of Residual Incomes by Region for Loan Amounts of $80,000 and Above

Family Size	Northeast	Midwest	South	West
1	$450	$441	$441	$491
2	$755	$738	$738	$823
3	$909	$889	$889	$990
4	$1,025	$1,003	$1,003	$1,117
5	$1,062	$1,039	$1,039	$1,158

For Family Size Over 5: Add $80 for each additional member up to a family of seven.

Continued on next page

Topic 9: How to Complete VA Form 26-6393, Loan Analysis, continued

e. Balance Available for Family Support – Item 43, continued

Table 11: Key to Geographic Regions Used on the Preceding Tables (Tables 6 and 7)

Geographic Region	States
Northeast	Connecticut, Maine, Massachusetts, New Hampshire, Vermont, New Jersey, New York, Pennsylvania, Rhode Island
Midwest	Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin
South	Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, Puerto Rico, South Carolina, Tennessee, Texas, Virginia, West Virginia
West	Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming

Examples

A Veteran has a family size of 3 purchasing a home in Arizona with a loan amount of $400,000. The residual figure will be $990.

A Veteran has a family size of 8 purchasing a home in Georgia with a loan amount of $150,000. The residual figure will be $1,199 (family size of 5 which is $1,039 adding $80 for each additional family member up to a family size of 7). The eighth person will not be considered in the calculation.

Special Instructions

Count all members of the household (without regard to the nature of the relationship) when determining "family size," including:

- A borrower's spouse who is not joining in title or on the note, and
- Any other individuals who depend on the borrower for support.

If a dependent is claimed on the Federal Tax Returns, then the dependent must be considered as a member of the household, to calculate residual income.

Examples

- Children from a spouse's prior marriage who are not the borrower's legal dependents.
- A dependent parent.

Continued on next page

Topic 9: How to Complete VA Form 26-6393, Loan Analysis, continued

e. Balance Available for Family Support – Item 43, continued

Exceptions for Considering All Members of the Household

The lender may omit any individuals from "family size" who are fully supported from a source of verified income which, for whatever reason, is not included in effective income in the loan analysis.

Examples

- a spouse not obligated on the title or on the note that has stable and reliable income sufficient to support his or her living expenses.
- a child for whom sufficient foster care payments or child support is received regularly, or
- a parent who has sufficient stable and reliable non-taxable income.

Reducing the Residual Income Figures

Reduce the residual income figure (from the above tables) by five percent if:

- the borrower(s) is an active duty or retired serviceperson, or
- there is a clear indication that a borrower will receive the benefits resulting from use of military-based facilities located near the property. Examples include Guard and Reserve military retirees, 100 percent disabled Veterans and their family members, or Medal of Honor recipients.

f. Debt-to-Income Ratio – Item 44

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, and other debt) to gross monthly income. The following steps are required to determine the debt-to-income ratio:

Table 12: Steps to Determine the Debt-to-Income Ratio

Step	Description
1	Add: Items 15+16+17+18+20+40 = Debt
2	Add: Items 31+38 = Income
3	Divide: Debt ÷ Income = Debt-to-Income Ratio
4	Round: To the nearest two digits

The "Debt-to-Income Ratio" heading in Topic 10, subsection b of this chapter contains special procedures to apply if the ratio exceeds 41 percent.

Only the borrower's actual income may be used to calculate the residual income.

Care should be exercised to ensure that the income considered tax-exempt is likely to continue and remain untaxed.

Continued on next page

Topic 9: How to Complete VA Form 26-6393, Loan Analysis, continued

b. Debt-to-Income Ratio – Item 44, continued

Tax-free income includes certain military allowances, child support payments, workers' compensation benefits, disability retirement payments, and certain types of public assistance payments.

Verify that the income is indeed tax-free before "grossing up."

Tax-free income may be "grossed up" for purposes of calculating the debt-to- income ratio only.

- This is a tool that may be used to lower the debt ratio for borrowers who clearly qualify for the loan.
- "Grossing up" involves adjusting the income upward to a pre-tax or gross income amount which, after deducting state and Federal income taxes, equals the tax-exempt income.
- Use current IRS and state income tax withholding tables to determine an amount which can be prudently employed to adjust the borrower's actual income. Use a figure of 125 percent of the borrower's non- taxable income when "grossing up."
- Do not add non-taxable income to taxable income before "grossing up."
- If "grossing up" is used, indicate such and provide the "grossed up" ratio of 125 percent in item 47, "Remarks." The actual amounts of the borrower's non-taxable income should not be adjusted in in line 38.

c. Past Credit Record – Item 45

Indicate whether the borrower (and spouse, if applicable) is a satisfactory or unsatisfactory credit risk based on a complete analysis of credit data.

Topic 10: How to Analyze the Information on VA Form 26-6393, Loan Analysis

Change Date: February 22, 2019

- This chapter has been revised in its entirety.

a. Residual Income

VA's minimum residual incomes (balance available for family support) are a guide. They should not automatically trigger approval or rejection of a loan. Instead, consider residual income in conjunction with all other credit factors.

However, an inadequate residual income alone can be a basis for disapproving a loan.

If residual income is marginal, look to other indicators such as the borrower's credit history, and in particular, whether and how the borrower has previously handled similar housing expense.

Consider the ages of the borrower's dependents in determining the adequacy of residual income.

b. Debt-to-Income Ratio

VA's debt-to-income ratio is a ratio of total monthly debt payments (housing expense, installment debts, and other obligations listed in section D of VA Form 26-6393, *Loan Analysis*, to gross monthly income. It is a guide and, as an underwriting factor, it is secondary to the residual income. It should not automatically trigger approval or rejection of a loan. Instead, consider the ratio in conjunction with all other credit factors.

A ratio greater than 41 percent requires close scrutiny unless:

- the ratio is greater than 41 percent unless it is larger due solely to the existence of tax-free income which should be noted in the loan file), the loan may be approved with justification, by the underwriter's supervisor, or
- residual income exceeds the guideline by at least 20 percent.

Loans closed automatically with a debt-to-income ratio greater than 41 percent:

- Include a statement justifying the reasons for approval, signed by the underwriter's supervisor, unless residual income exceeds the guideline by at least 20 percent.
- The statement must include the reason(s) for approving the loan and list the compensating factors justifying approval of the loan.

c. Credit History

A poor credit history alone is a basis for disapproving a loan.

If credit history is marginal, look to other factors such as residual income.

Continued on next page

Topic 10: How to Analyze the Information on VA Form 26-6393, Loan Analysis, continued

d. 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 strengths rather than mere satisfaction of basic program requirements. For example, the fact that a borrower 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 downpayment,
- 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.

e. Compare Previous and Proposed Shelter Expenses

Closely scrutinize a case in which the borrower will be paying significantly higher shelter expenses than he or she currently pays.

Consider the:

- ability of the borrower to accumulate liquid assets, and
- amount of debts incurred while paying a less amount for shelter.

If a borrower's application shows little or no reserves and excessive obligations, it may not be reasonable to conclude that a substantial increase in shelter expenses can be absorbed.

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Topic 10: How to Analyze the Information on VA Form 26-6393, Loan Analysis, continued

f. Home Mortgage Disclosure Act (HMDA)

As a result of releases of Home Mortgage Disclosure Act (HMDA) data, many lenders are increasingly concerned that they are taking all appropriate measures to assure access by minorities and lower income households to home mortgage loans. VA believes that it is important for lenders to be aware of how effectively the VA Home Loan Program can assist them in meeting this goal.

Compatibility of VA Program with HMDA

The no down payment feature is, of course, a primary advantage for individuals with low-to-moderate incomes. However, lenders should not overlook other aspects of the VA program that will help in underwriting loans for such borrowers. VA Credit Standards are written as guidelines and are meant to be interpreted and used just that way, taking into consideration all of an individual loan borrower's financial, employment and family circumstances.

Purpose of HMDA

VA encourages underwriters to find ways to approve loan applications which ought to be approved but may not appear approvable upon direct application of the credit standards.

Underwriters are encouraged to give consideration to every possible appropriate factor in seeking a proper basis for approving loan applications for every qualified Veteran.