



Bankers Advisory

COMPLIANCE MONITOR

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FHA Issues New Manual Underwriting Requirements

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December 11, 2013, HUD published in the Federal Register its final notice entitled, "*Federal Housing Administration (FHA) Risk Management Initiatives: New Manual Underwriting Requirements.*" The manual underwriting requirements are applicable for purchase transactions and all credit qualifying FHA refinance transactions.

The effective date of the new manual underwriting requirements shall be announced by Mortgagee Letter and effective no earlier than March 11, 2014.

Summary of Major Changes

HUD has made five changes to the proposed manual underwriting requirements at this stage:

First, HUD has taken the opportunity to address the issue of borrowers who exceed the 31 percent housing-to-income ratio, yet carry little or no discretionary debt and, therefore, do not exceed the maximum 43 percent debt-to-income ratio.

Second, HUD has addressed the relationship between compensating factors and "stretch ratios" that permit borrowers to exceed the housing payment and total debt-to-income ratios under certain FHA mortgage insurance programs.

Third, the rule establishes additional compensating factors that can be used to qualify borrowers who exceed FHA's standard housing payment and debt to income ratios.

Fourth, HUD has reduced the credit score (from 620 to 580) below which compensating factors may not be cited and the standard ratio guidelines may not be exceeded.

Fifth, HUD has extended the applicability of these underwriting policies to FHA-to-FHA rate and term refinance transactions (no cash-out) and credit-qualifying FHA streamline refinance transactions.

Manually underwritten loans are required to have reserves equal to at least one full monthly mortgage payment (1-2 unit properties) or three full monthly mortgage payments (3-4 unit properties).

FHA currently has standard guidelines for the debt-to-income ratios. The mortgage payment-to-income ratio (the front-end ratio) may not exceed 31 percent, and the total fixed payment-to-income ratio (the back-end ratio) may not exceed 43 percent. Either or both of these ratios may be exceeded provided that there are compensating factors.

For manually underwritten loans with insufficient credit references and with greater than 31/43 ratios, HUD currently does not allow for compensating factors. Under this ruling, HUD will continue not to allow for compensating factors for these borrowers.

The rule establishes for manually underwritten loans a maximum front ratio and a maximum back ratio that may not be exceeded based on the borrower's credit score. Borrowers with no credit score or with credit scores below 580 may not exceed the standard 31/43 ratios.

Borrowers with credit scores of 580 or higher may be approved for ratios as high as 37/47 with one compensating factor, and 40/50 with two compensating factors. In addition, the final document restricts the use of compensating factors to borrowers with credit scores of 580 or higher.

Borrowers not meeting this standard are limited to maximum ratios of 31/43 unless they meet the Energy Efficient Mortgage requirements which provide maximum stretch ratios of 33/45.

Solicitation of Comments Regarding Credit Score Reduction

As noted above, and discussed in more detail in the response to comments that follows, HUD has reduced the credit score (from 620 to 580) below which compensating factors may not be cited and the standard ratio guidelines may not be exceeded. This change will expand the pool of eligible borrowers who may qualify for the use of such compensating factors. Although the ruling is being issued for effect, HUD invites public comment on this one change. HUD is not soliciting comments on other aspects of the document. Comments on the revised credit score threshold for use of compensating factors are due on or before February 10, 2014. Comments must be submitted electronically or by mail.



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