FHA Throws Lifeline to Those With Damaged Credit During Recession

By: Matthew Graham | Mon, Aug 19 2013, 2:05 PM

The financial crisis took its toll on Wall Street and Main Street alike. Mistakes were made and bills went unpaid on both sides of the fence, but Main Street sees Wall Street bailouts and asks "**where's my bailout?**" Specifically with respect to the housing market, borrowers who have had bankruptcies, foreclosures, deeds-in-lieu, short-sales, or other adverse credit have heretofore been unable to quickly reestablish themselves as worthy borrowers. That's changing.

Late last week, The Department of Housing and Urban Development on Thursday unveiled a new set of guidelines under the FHA program specifically geared toward homeowners and prospective homeowners adversely impacted by the Great Recession. The "Back to Work" program, as it's called, **doesn't constitute a free pass** for those who would otherwise be unable to qualify for financing, but it does reopen the housing market to a great many borrowers who would otherwise have been waiting for 3-7 years to tick off the clock--depending on their initial credit issue--before being able to qualify for a mortgage. In FHA's words:

"As a result of the recent recession many borrowers who experienced unemployment or other severe reductions in income, were unable to make their monthly mortgage payments, and ultimately lost their homes to a pre-foreclosure sale, deed-in-lieu, or foreclosure. Some borrowers were forced to file for bankruptcy to discharge or restructure their debts. Because of these recent recession-related periods of financial difficulty, borrowers' credit has been negatively affected. FHA recognizes the hardships faced by these borrowers, and realizes that their credit histories **may not fully reflect their true ability** or propensity to repay a mortgage."

The program will require prospective borrowers to **thoroughly document** the nature of the "Economic Event," that it resulted in derogatory credit, and that there has been a satisfactory recovery from the Event per the new guidelines.

Lenders will consider the **Economic Event to have caused the derogatory credit** if:

- The prospective borrowers had satisfactory credit prior to the event onset
- The prospective borrowers' derogatory credit occurred after the onset of the event
- The prospective borrowers have reestablished satisfactory credit for at least 12 months since the the end of the event

Lenders will consider borrowers to have **reestablished satisfactory credit** if:

- The borrower has no late housing or installment debt payments for the past 12 months
- Open mortgage accounts are current and have been paid on time for the past 12 months
- Borrowers have adhered to the agreement of any open modification plan for the past 12 months
- Complete a course of Housing Counseling in person, via telephone, via internet, or other methods approved by HUD (who provides a list of Counseling agencies).

For the purposes of this program, an **"Economic Event" is defined** as "any occurrence beyond the borrower's control that results in loss of employment, loss of income, or a combination of both, which causes a reduction in the borrower's household income of twenty (20) percent or more for a period of at least six (6) months. The Onset of an Economic Event is the month of loss of employment/income." Lenders will verify the reduction in income or loss of employment with at least one of the following:

- A written termination notice
- Other publicly available documentation of the business closure
- Documentation of the receipt of Unemployment Income

Additionally, **lenders have to verify** a 20 percent loss of income due to the Economic Event by documenting borrowers' income prior to the event. This requirement can be satisfied either with a written "Verification of Employment" form with income details provided by the employer or signed tax returns (or W-2s).

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