

Homebuyers Lose Again As FHA Tightens Guidelines

By: Ted Rood | Fri, Oct 18 2013, 5:11 PM

Despite declining FHA loan originations (from 120,917 in April 2013 to 105,995 in July), HUD issued Mortgagee Letter 2013-24 on August 15, tightening FHA borrower restrictions effective October 15. FHA raised upfront and monthly mortgage insurance premiums (and made monthly MIP effective for the life of the loan) earlier this year, leaving FHA loans far less desirable for many buyers. The new guidelines will most affect **credit challenged buyers**, those least likely to qualify for loans outside the FHA program.

For borrowers with **collections** totaling over \$2,000, FHA now requires lenders using the Total Scorecard underwriting system to include monthly payments for the first time. While some collections report a minimum payment on credit reports, most do not, and lenders will assume a payment of 5% of the outstanding balance. Adding the assumed payments will raise buyers' debt ratios, reduce their purchasing power, and potentially prevent some from purchasing homes.

Guidelines for loans underwritten manually are **even more stringent**, requiring letters of explanation and supporting documentation from borrowers on collection accounts. Underwriters will have to determine if the account resulted from a "borrower's disregard for financial obligations, inability to manage debt, or extenuating circumstances". Minimum payments must still be added to debt ratios, whether the collections total \$2000 or not.

Medical bills are exempt from the new guidelines, but old credit card accounts, utility bills, and other liabilities must be included if listed as a collection on credit reports. Lenders (who have historically ignored many collections) will have to be vigilant to ensure they correctly calculate clients' debt ratios, especially while doing buyer pre-approvals.

HUD's continued guideline changes have left many FHA borrowers seeking **alternatives** such as [Fannie Mae's 5% down payment program](#). Those with challenged credit scores and debt ratios above Fannie requirements now face additional hurdles to obtaining financing. Astute buyers will examine their credit reports and obtain [pre-approval letters](#) well in advance of writing sales offers to avoid potential delays and stress during the loan process.

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