

# Underwriting Reminders for Loan Product Advisor® Caution Risk Class Mortgages

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

## All Caution Mortgages (Guide Topics 5100 through 5500)

For all Caution Mortgages, the Seller must manually underwrite the mortgages and assess the borrower's capacity to repay in accordance with Topics 5100 through 5500. For such mortgages, there is a strong indication that the layering of risk is excessive and that acceptability and compliance with Freddie Mac requirements is unlikely.

**Note:** Guide Bulletin [2023-16](#): For manually underwritten mortgages you may exclude medical collections from being considered adverse or derogatory credit information.

**Note:** Timeshare loans are considered installment debts, regardless of how they are reported on the borrower's credit report; therefore, payments on timeshare loans are not considered housing payments for purposes of evaluating late housing payments, refer to Guide Section 5202.5(a). Additionally, the foreclosure recovery time periods for reestablishment of credit do not apply to timeshare loans in foreclosure, refer to Guide Section 5202.5(a)

Reconcile any material discrepancies between loan application and the credit report used to document the file.

When the credit report indicates that a creditor has made an inquiry within the previous 90-day period, you **must** determine if additional credit was granted. If additional credit was granted, verification of the debt must be obtained and the debt must be considered when qualifying the borrower subject to the requirements in Sections [5401.2](#), Monthly debt payment-to-income ratio. (See Guide Section [5202.6](#))

**Caution Borrower Credit:** Manually underwrite in accordance with Guide Sections [5102.2\(b\)\(iii\)](#), [5202.3](#), [5202.4](#) and [5202.5](#). Credit Fees in Price apply.

### Due to Credit

The Seller is responsible for demonstrating an acceptable credit reputation. When there are at least two Feedback Certificate messages related to nonpayment of obligations, the Seller must presume the derogatory information is significant. The Seller must document:

- Extenuating circumstances, or, conclude that the difficulties were due to financial mismanagement.
- Offsetting factors (*factors not already assessed by Loan Product Advisor*) to ensure that the mortgage is acceptable for the factors identified in the *Credit and Liabilities Messages section* of the Feedback Certificate.

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

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<b>Caution– Borrower Credit, <i>continued</i></b>					
<b>Evaluating Credit Reputation</b>	<p>The following subsections under Borrower Credit are Significant Derogatory Credit Requirements based on Extenuating Circumstances and/or Financial Mismanagement requirements.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="background-color: #e1f5fe;"><i>Extenuating Circumstances</i></th> <th style="background-color: #e1f5fe;"><i>Financial Mismanagement</i></th> </tr> </thead> <tbody> <tr> <td style="vertical-align: top;"> <p>Freddie Mac considers an extenuating circumstance to be a nonrecurring or isolated circumstance, or set of circumstances that:</p> <ul style="list-style-type: none"> <li>▪ Was beyond the borrower's control,</li> <li>▪ Significantly reduced income and/or increased expenses, and</li> </ul> <p>Rendered the borrower unable to repay obligations as agreed, resulting in significant adverse or derogatory credit information.</p> <p>In addition, if the borrower's credit history includes significant adverse or derogatory credit within the most recent two years, even if it was caused by extenuating circumstances, the borrower's credit reputation cannot be considered acceptable.</p> <p>When the Seller uses extenuating circumstances to justify the borrower's credit reputation is acceptable despite significant adverse or derogatory information, the Seller must confirm the extenuating circumstances and that the borrower has reestablished an acceptable credit reputation.</p> <p>If the Seller cannot obtain third-party documentation confirming the extenuating circumstances and reestablishment of credit, it cannot consider the extenuating circumstance as an acceptable offset to significant adverse or derogatory credit information.</p> </td> <td style="vertical-align: top;"> <p>If the Seller is unable to document extenuating circumstances in accordance with Freddie Mac's requirements, then it must conclude the problems were due to financial mismanagement.</p> </td> </tr> </tbody> </table>	<i>Extenuating Circumstances</i>	<i>Financial Mismanagement</i>	<p>Freddie Mac considers an extenuating circumstance to be a nonrecurring or isolated circumstance, or set of circumstances that:</p> <ul style="list-style-type: none"> <li>▪ Was beyond the borrower's control,</li> <li>▪ Significantly reduced income and/or increased expenses, and</li> </ul> <p>Rendered the borrower unable to repay obligations as agreed, resulting in significant adverse or derogatory credit information.</p> <p>In addition, if the borrower's credit history includes significant adverse or derogatory credit within the most recent two years, even if it was caused by extenuating circumstances, the borrower's credit reputation cannot be considered acceptable.</p> <p>When the Seller uses extenuating circumstances to justify the borrower's credit reputation is acceptable despite significant adverse or derogatory information, the Seller must confirm the extenuating circumstances and that the borrower has reestablished an acceptable credit reputation.</p> <p>If the Seller cannot obtain third-party documentation confirming the extenuating circumstances and reestablishment of credit, it cannot consider the extenuating circumstance as an acceptable offset to significant adverse or derogatory credit information.</p>	<p>If the Seller is unable to document extenuating circumstances in accordance with Freddie Mac's requirements, then it must conclude the problems were due to financial mismanagement.</p>
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<b>Minimum Indicator Score</b>	<p>The Mortgage must meet the Minimum Indicator Score requirements for manually underwritten Mortgages. Refer to <a href="#">Guide Exhibit 25</a>, Mortgages with Risk Class and/or Minimum Indicator Score Requirements.</p>				



**Caution– Borrower Credit, *continued***

<p><b>Recovery Time Periods for Reestablishing Credit</b></p>	<p><b><i>Extenuating Circumstances</i></b></p>	<p><b><i>Financial Mismanagement</i></b></p>
	<p>Must have reestablished an acceptable credit reputation for a period of at least:</p> <ul style="list-style-type: none"> <li>▪ 36 months from the completion date as reported on the credit report for a <b>previous foreclosure*</b>, or, <ul style="list-style-type: none"> <li>▪ When foreclosure resulted from a mortgage that was extinguished in Chapter 7 bankruptcy, the recovery time period for a Chapter 7 bankruptcy caused by extenuating circumstances may be applied and counted from the date of the bankruptcy discharge, provided that: <ul style="list-style-type: none"> <li>○ The mortgage file must include documentation supporting that the foreclosure resulted from a mortgage that was extinguished in the Chapter 7 bankruptcy, <b>and</b></li> <li>○ The foreclosure proceedings did not begin before the bankruptcy filing, <b>and</b></li> <li>○ The mortgage was not reaffirmed through the bankruptcy</li> </ul> </li> </ul> </li> <li>▪ 24 months from the execution date of a <b>deed-in-lieu of foreclosure*</b></li> <li>▪ 24 months from the completion date of any <b>short sale*</b></li> <li>▪ 24 months after the discharge or dismissal of a <b>bankruptcy</b>,</li> <li>▪ 24 months for all other significant adverse or derogatory credit information</li> </ul>	<p>Must have reestablished an acceptable credit reputation for a period of at least:</p> <ul style="list-style-type: none"> <li>▪ 84 months from the completion date as reported on the <b>credit report for a previous foreclosure</b>, or, <ul style="list-style-type: none"> <li>○ When foreclosure resulted from a mortgage that was extinguished in Chapter 7 bankruptcy, the recovery time period for a Chapter 7 bankruptcy caused by financial mismanagement may be applied and counted from the date of the bankruptcy discharge, provided that: <ul style="list-style-type: none"> <li>○ The mortgage file must include documentation supporting that the foreclosure resulted from a mortgage that was extinguished in the Chapter 7 bankruptcy, <b>and</b></li> <li>○ The foreclosure proceedings did not begin before the bankruptcy filing, <b>and</b></li> <li>○ The mortgage was not reaffirmed through the bankruptcy</li> </ul> </li> </ul> </li> <li>▪ 48 months from execution date of a <b>deed-in-lieu of foreclosure*</b></li> <li>▪ 48 months from the completion date for a <b>short sale*</b></li> <li>▪ 48 months after the discharge or dismissal date of a <b>Chapter 7</b> and/or <b>Chapter 11</b> bankruptcy</li> <li>▪ 24 months after the <u>discharge date</u> of a <b>Chapter 12</b> and/or <b>Chapter 13</b> bankruptcy, or 48 months after the <u>dismissal date</u> of a Chapter 12 and/or Chapter 13 bankruptcy</li> <li>▪ 60 months from the most recent discharge or dismissal date when the borrower has <b>filed more than one bankruptcy</b> petition in the past seven years</li> <li>▪ 48 months for all other significant adverse or derogatory credit information</li> </ul>



Caution– Borrower Credit, <i>continued</i>		
Recovery Time Periods for Reestablishing Credit - Additional Requirements (cont'd)	<i>Extenuating Circumstances</i>	<i>Financial Mismanagement</i>
	<p>*Additional requirements, as applicable:</p> <p><b>For a previous foreclosure, deed-in-lieu of foreclosure or short sale within the last seven years</b>, the Mortgage must be either be:</p> <ul style="list-style-type: none"> <li>▪ A purchase transaction secured by a Primary Residence with a maximum LTV/TLTV/HTLTV ratio of the lesser of 90% or the maximum LTV/TLTV/HTLTV ratio for the transaction, or</li> <li>▪ A “no cash-out” refinance Mortgage meeting the requirements of Guide Chapter 4301.</li> </ul>	<p>*Additional requirements, as applicable:</p> <p><b>For a previous deed-in-lieu of foreclosure or short sale within the last seven years</b>, the Mortgage must be either be:</p> <ul style="list-style-type: none"> <li>▪ A purchase transaction secured by a Primary Residence with a maximum LTV/TLTV/HTLTV ratio of the lesser of 90% or the maximum LTV/TLTV/HTLTV ratio for the transaction, or</li> <li>▪ A “no cash-out” refinance Mortgage meeting the requirements of Guide Chapter 4301.</li> </ul>



**Caution– Borrower Credit, *continued***

**Documentation**

<i>Extenuating Circumstances</i>	<i>Financial Mismanagement</i>
<p>Mortgage file must contain:</p> <ul style="list-style-type: none"> <li>▪ A written statement from the borrower, in the form of a signed letter or an e-mail directly from the borrower, regarding the cause of the financial difficulties to outside factors beyond the borrower’s control and are unlikely to recur</li> <li>▪ Third-party documentation confirming that the events related by the borrower in the explanation were an isolated occurrence and significantly reduced the borrower’s income and/or increased expenses and rendered the borrower unable to repay as agreed</li> <li>▪ Evidence on the credit report and other documentation in the mortgage file of the length of time since completion of the significant derogatory event to the date of application and of completion of the recovery time period requirements.</li> </ul>	<p>Mortgage file must contain:</p> <ul style="list-style-type: none"> <li>▪ Evidence the borrower has reestablished an acceptable credit reputation as required in Topics 5100 and 5200 for Manually Underwritten Mortgages</li> <li>▪ Evidence on the credit report and other credit documentation in the mortgage file of the length of time since completion of the significant derogatory event to the date of the application, and of completion of the recovery time period requirements.</li> </ul>

**Additional documentation:**

- Foreclosure, deed-in-lieu of foreclosure or short sale:
  - Evidence of completion
- Bankruptcy within the last 7 years:
  - Copies of the bankruptcy petition, schedule of debts and discharge or dismissal
  - Evidenced to indicate that all debts not satisfied by the bankruptcy have been paid or are being paid
  - Any other evidence necessary to support your determination that the borrower has reestablished and maintained an acceptable credit reputation



**Caution– Borrower Credit, *continued***

**Underwriting Analysis (Form 1077)**

<i>Extenuating Circumstances</i>	<i>Financial Mismanagement</i>
<ul style="list-style-type: none"> <li>▪ The Seller must explain on the Form 1077 (or other document in the file) the rationale supporting its determination that:</li> <li>▪ The events causing the financial difficulties were beyond the borrower’s control, are not ongoing, and are unlikely to recur</li> <li>▪ An acceptable credit reputation has been reestablished</li> </ul> <p>Freddie Mac also recommends that you provide calculations for significant qualifying data (income, assets, debts, reserves) and the reasoning for your lending decision.</p>	<ul style="list-style-type: none"> <li>▪ The Seller must explain on the Form 1077 (or other document in the file) the rationale supporting its determination that:</li> <li>▪ Financial mismanagement is unlikely to recur</li> <li>▪ An acceptable credit reputation has been reestablished.</li> </ul> <p>Making a case that the borrower is sufficiently willing to repay obligations when significant derogatory information was caused by financial mismanagement is very difficult. It will take a longer and more convincing reestablishment period to overcome derogatory information caused by financial mismanagement.</p> <p>Freddie Mac also recommends that you provide calculations for significant qualifying data (income, assets, debts, reserves) and the reasoning for your lending decision.</p>



<b>Caution– Borrower Capacity:</b> Manually underwrite in accordance with Guide Topics 5100 through 5500. Credit Fees in Price apply.	
<b>Due to Capacity</b>	You are responsible for demonstrating acceptable capacity, including when the Feedback Certificate contains credit risk comments related to capacity.
<b>Compensating Factors</b>	<ul style="list-style-type: none"> <li>▪ The Seller may not use information already considered by Loan Product Advisor to determine that capacity is acceptable. See Guide Section <a href="#">5101.2</a> (b)(iii) for factors considered by Loan Product Advisor.</li> <li>▪ Factors not considered by Loan Product Advisor, such as the existence of verified income that is not included in the submission or energy savings from an energy-efficient property (see Guide Section <a href="#">5401.1</a>), may be used by the Seller in making a case that capacity is acceptable.</li> </ul>
<b>Unacceptable Capacity</b>	<p>The Seller must presume the borrower's capacity to repay is not acceptable when the following conditions exist (see Guide Section <a href="#">5102.2</a>(b)(iii)):</p> <ul style="list-style-type: none"> <li>▪ The Mortgage is a Loan Product Advisor Caution Mortgage, and</li> <li>▪ The transaction is a cash-out refinance, and</li> <li>▪ At least one Credit Risk Comment related to the monthly debt payment-to-income ratio is returned on the Feedback Certificate</li> </ul>
<b>Ratios</b>	<ul style="list-style-type: none"> <li>▪ When either of the ratio guidelines (28% monthly housing expense-to-income ratio and 36% monthly debt payment-to-income ratio) is exceeded, the Seller must prepare and retain in the Mortgage file a written explanation justifying its underwriting decision. (See Guide Sections <a href="#">5102.2</a>(b)(i), <a href="#">5401.1</a>, <a href="#">5401.2</a>(c))</li> </ul> <p><b>Note:</b> The total debt-to-income ratio must not exceed 45%.</p>

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