

Responsible Lending: The Power of Strong Underwriting

We've all witnessed the recent downturn in the mortgage market. You may be seeing a significant number of loans go into default, causing undue strain on your borrowers, your company, the financial industry and the economy.

By focusing on strengthening your underwriting and quality control practices, you can improve the quality of mortgages delivered to the secondary market, and reduce the costly impact of defaults and repurchases. Working together, we can help stabilize the housing market, foster successful long-term homeownership for qualified borrowers, and rebuild consumer confidence.

Strong Underwriting Starts Here

Promoting responsible lending standards and rebuilding a sound mortgage industry requires strengthening underwriting requirements to help ensure that mortgages can withstand the ups and downs of the market. Focusing on credit, capacity, and collateral, the three C's of underwriting, and taking proactive measures to prevent fraud can help to move you and the mortgage industry closer to rebuilding a sound mortgage industry and help sustain homeownership for America's families.

Improving the quality of mortgage lending will help stabilize the housing market and foster successful long-term homeownership for qualified borrowers. In order to achieve these goals, we should work to prevent the underwriting errors of the past from re-embedding themselves in current underwriting practices. The path to strong underwriting begins here, by answering these questions:

- **Credit** — Based on the borrower's overall credit history, will the borrower repay the mortgage? The borrower's credit history is a good indicator of how they will manage their future debt. The credit history and credit score should be reviewed along with the application and current credit report.
- **Capacity** — Can the borrower repay the mortgage? The likelihood that the borrower will be able to repay the mortgage; can be determined by analyzing and reviewing the borrower's employment, income, obligations and assets. Is the borrower's employment and income stable? Is the borrower's income sufficient to pay all of their obligations? Is there sufficient equity in the transaction to compel repayment?
- **Collateral** — What if the borrower is not able to repay the mortgage? Will the property be worth enough to pay off the loan? There needs to be a thorough review of the appraisal, analysis of the property, its neighborhood and the appraisal to verify that the value is supported.
- **Fraud prevention** — Does the information in the file make sense? Are there red flags that need further investigation? Are there processes in place, in your shop, that will allow additional investigation to occur?

Automated underwriting should be viewed as a tool to help evaluate the risk of a loan. There are many aspects of a loan that are beyond the scope of automated underwriting. It is important for your staff to calculate the income, assets and liabilities correctly and review for potential fraud so the automated tool can assess the risk.

Best practices for successful underwriting in today's market:

- Enter complete data into the AUS and review it thoroughly for accuracy
- Validate data with the borrower to ensure accuracy
- Understand today's income calculation requirements
- Provide all necessary income documentation in the mortgage file
- Adequately support property value with legitimate comparables
- Adhere to the AUS checklist/requirements
- Ask questions if you discover inconsistencies in the documentation

Underwriting Basics

In today's market, the most common deficiencies found in mortgage files include: incorrect income and asset calculations, insufficient asset verification, incorrect liability calculation, and occupancy misrepresentation. In order to help prevent these common deficiencies, we encourage you to use the following steps to improve the underwriting and quality control practices within your business.

- **Revisit the basics of underwriting.** Strong underwriting involves understanding the risk components of credit, capacity, and collateral as part of any lending decision and performing a deeper analysis during the underwriting process to determine the borrower's ability to repay. We encourage you and your staff to stay current on requirements with proper training.
- **Establish basic underwriting controls.** Basic underwriting pitfalls can be avoided with thoughtful underwriting, which requires the establishment of basic controls in your underwriting process. These include reviewing the loan application and borrower documentation thoroughly to ensure all requirements and conditions are met; validating and revalidating data entered into any automated underwriting system (AUS); and ensuring there is proper oversight of underwriting decisions and proper checks and sign-offs in the process.
- **Use your sound underwriting judgment.** Do not hesitate to ask your borrowers more questions to validate data accuracy, and be aware of inconsistencies. If the appraisal is questionable, ensure you have a documented process to gather additional information to support the estimated value.

Our research has shown that a loan that is not eligible for sale to Freddie Mac, based on our [Single-Family Seller/Service Guide](#) requirements, is substantially more likely to go into default than a loan that meets Freddie Mac's guidelines.

Training and Resources

To assist you in establishing prudent and consistent underwriting practices in today's environment and minimize costly defaults and repurchases, Freddie Mac is providing you with a robust set of tools, training, and support. We highly encourage you to utilize these resources and provide your staff sufficient opportunity to obtain proper training in basic underwriting practices by [enrolling in Freddie Mac training courses](#). It is more critical than ever that your staff has the experience and training to review appraisals to ensure appraisals support the estimated values.

Utilize these resources to help strengthen your underwriting and quality control practices:

- Visit the Learning Center for a [comprehensive set of training courses and tools](#) that focus on underwriting principles and best practices.
- Review the [Loan Prospector® Documentation Matrix](#).
- Review Freddie Mac's quality control best practices.
- Implement automated valuation models (AVMs) and other tools as part of the origination or pre-funding quality control process to detect fraud and objectively measure the accuracy of the appraisal. Freddie Mac recommends the use of [Home Value Explorer®](#), [Home Value Calibrator®](#) or other validated and tested AVMs, as well as other collateral valuation tools.
- Keep current on underwriting requirements and modifications to ensure delivery of eligible mortgages to Freddie Mac by reviewing [Freddie Mac requirements](#).
- [Credit reputation, capacity, and collateral](#) are major underwriting factors used in Loan Prospector's assessment of loans.

Our focus is clear — to help stabilize and support the housing market and ultimately, the U.S. economy.
