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Question

How does a bankruptcy affect a borrower's eligibility for an FHA mortgage?

Answer

The Mortgagee must document the passage of two years since the discharge date of any bankruptcy. If the bankruptcy was discharged within two years from the date of case number assignment, the Mortgage must be downgraded to a Refer and manually underwritten.

If the credit report does not verify the discharge date or additional documentation is necessary to determine if any liabilities were discharged in the bankruptcy, the Mortgagee must obtain the bankruptcy and discharge documents.

For Manually Underwritten loans:

A Chapter 7 bankruptcy (liquidation) does not disqualify a Borrower from obtaining an FHA-insured Mortgage if, at the time of case number assignment, at least two years have elapsed since the date of the bankruptcy discharge. During the most recent two years, the Borrower must have:

- re-established good credit; or
- chosen not to incur new credit obligations.

An elapsed period of less than two years, but not less than 12 months, may be acceptable, if the Borrower:

- can show that the bankruptcy was caused by extenuating circumstances beyond the Borrower's control; and
- has since exhibited a documented ability to manage their financial affairs in a responsible manner.

A Chapter 13 bankruptcy does not disqualify a Borrower from obtaining an FHA-insured Mortgage, if at the time of case number assignment at least 12 months of the pay-out period under the bankruptcy has elapsed.

The Mortgagee must determine that during the most recent 12 months, the Borrower's payment performance has been satisfactory and all required payments have been made on time; and the Borrower has received written permission from bankruptcy court to enter into the mortgage transaction.

If the credit report does not verify the discharge date or additional documentation is necessary to determine if any liabilities were discharged in the bankruptcy, the Mortgagee must obtain the bankruptcy and discharge documents.

The Mortgagee must also document that the Borrower's current situation indicates that the events which led to the bankruptcy are not likely to recur.

For additional information see Handbook 4000.1 II.A.4.b.iii(F) and II.A.5.a.iii(H) at <https://www.hud.gov/hud-partners/single-family-handbook-4000-1> (<https://www.hud.gov/hud-partners/single-family-handbook-4000-1>)

▼ FAQ Notes

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