The importance of housing history

Housing History (rental or mortgage) is one the most important components of a loan application because it shows your ability to make large monthly payments over time. Mortgage history, in particular, also shows the ability to carry a large amount of debt over time.

Underwriters look at a factor called **payment shock**. Payment shock is defined as any significant increase in a monthly liability that heightens the risk of loan default. Simplified, the more you pay out every month to your creditors, the more likely you will be late on one or more of your payments, particularly if you are not in the habit of making such large payments.

For example, a couple shops for a home and finds one for $250,000. Their taxes will be $250 per month and their insurance adds another $50 for a total monthly principal, interest, tax, and insurance (PITI) payment of $1,600. If the couple has been making a rent payment of only $600, they could certainly be considered to have payment shock. It doesn't mean that a lender wouldn't allow it to happen. An underwriter would simply need to consider this factor when reviewing the application. Let's say the couple has a monthly income of $10,000. This is going to lessen the effect of payment shock considerably more than if their monthly income was $4,000 Their other debt payments, liquid cash reserves, and other factors would come into consideration as well.

This is why credit history, and in particular, housing payment history, is so very important. Customers who apply for a mortgage with little or no established credit will often face a series of hurdles, and that first hurdle is going to be rental history. If they have been living with Mom, Dad, or another relative, they haven't demonstrated the ability to handle large monthly payments.

Customers with no housing history must have a strong credit history, displaying their ability to make on-time payments and carry debt, such as an auto loan. They need to show a conservative use of credit card debt. They can show compensating factors such as:

- Regular savings (best case is a customer putting aside the amount of proposed mortgage payment each month when there is no mortgage or rent payment present)
- Cash reserves after closing (3 months minimum)
- High credit scores with a full open and active credit history
- Conservative use of credit cards (revolving debt)

Adding compensating factors to an application gives the underwriters something positive to weigh against the lack of housing history and improves the chances of loan approval. An underwriter is always going to review the whole picture, and not base their decision on just one factor.