

Understanding Bankruptcy and Homeownership

This guide explains how different types of bankruptcy affect loan eligibility and what lenders review during the underwriting process.

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A Comprehensive Guide by The Housing Assistant



Introduction

Bankruptcy doesn't mean the end of homeownership. Many borrowers can qualify for a mortgage after a bankruptcy, depending on the type filed, the time since discharge or dismissal, and the loan program guidelines. This guide explains how different types of bankruptcy impact loan eligibility and what lenders review during underwriting.

Types of Bankruptcy

Chapter 7 (Liquidation):

- Debtor's non-exempt assets are sold to pay creditors.
- Typically discharged in 3-6 months.

Chapter 13 (Reorganization):

- Debtor repays debt over 3–5 years per court-approved plan.
- Often used to stop foreclosure or catch up on arrears.

Chapter 11 (Business Reorganization):

- Generally applies to business entities, not individuals.
- May be reviewed if borrower is self-employed or owns a company.

What Lenders Evaluate

- Discharge vs. Dismissal – Discharged bankruptcies are more favorable than dismissed ones.
- Time Since Bankruptcy – Measured from discharge date.
- Re-established Credit – Has the borrower re-established trade lines?
- No New Delinquencies – All accounts must be current since discharge.
- Bankruptcy Explanation Letter – Some lenders require a written LOE.

- Documentation – Full bankruptcy paperwork including discharge/dismissal must be in file.

Waiting Periods by Loan Type

Loan Type	Chapter 7 Discharge	Chapter 13 Discharge	Chapter 13 in Repayment	Exceptions/Notes
FHA	2 years	1 year (on-time payments)	Allowed with 12 months payment history	Manual UW if <2 years
VA	2 years	1 year (on-time payments)	Allowed with trustee approval	Flexible if strong credit
USDA	3 years	1 year (on-time payments)	Allowed with court approval	GUS automated decision overrides
Conventional (FNMA/FHLMC)	4 years	2 years	Not permitted during plan	Extenuating circumstances = 2 yrs (Ch. 7)

Best Practices for Buyers After Bankruptcy

- Rebuild credit with secured cards or installment loans.
- Keep all debt payments current – no late payments post-discharge.
- Maintain stable employment and income.
- Save for down payment and reserves.
- Be ready to document any collections, disputes, or delinquencies.