When a VA Underwriting Review Says Refer: understanding compensating factors

A VA loan application that goes through automated underwriting and gets a Refer result can feel like a dead end. The system has flagged the file for a closer look, and many borrowers assume that means a denial. In reality, a Refer result opens the door to manual underwriting, where a human reviewer weighs the whole picture rather than letting a computer make the final call. The key to getting that manual approval often lies in what are called compensating factors.

Compensating factors are strengths in a borrower's financial profile that offset a specific risk. For example, a borrower might have a higher debt-to-income ratio than the VA guideline prefers, but also have a strong residual income or a long history of steady employment. The underwriter can look at those positives and decide that the overall risk is still acceptable. This is not about bending rules; it is about using the judgment that manual underwriting allows.



Understanding how compensating factors work within a VA underwriting review can help you prepare a stronger application. scarpero.com provides clear guidance for veterans navigating mortgage eligibility, and knowing what an underwriter considers a compensating factor is a practical part of that process. This article explains what these factors are, how they interact with the manual underwriting process, and what you can do to present them effectively.

How automated underwriting and manual underwriting differ

Automated underwriting systems evaluate a loan file against a set of statistical models. They look at credit scores, debt ratios, and other data points, then produce a result: Approve, Refer, or Decline. A Refer means the file has characteristics the system cannot assess on its own. It does not mean the loan is bad; it just means a person needs to review it.

Manual underwriting, by contrast, relies on a human underwriter who reviews the full file. That person can consider explanations, patterns, and context that an automated system cannot. If the borrower has a recent late payment because of a hospital stay, the underwriter can read the letter of explanation and see the full story. If the borrower has high debt but also a large amount of residual income at the end of each month, the underwriter can factor that in. This flexibility is why compensating factors matter so much in manual underwriting.



Common compensating factors that support manual VA approval

The VA does not publish a strict list of compensating factors, but industry practice has settled on several that underwriters routinely accept. These include:

- **Residual income.** This is the money left after paying all monthly obligations, including the new mortgage payment. The VA sets minimum residual income thresholds by region and family size. If your residual income exceeds that minimum by a healthy margin, it can compensate for a higher debt ratio or a lower credit score.
- **Strong employment history.** Two or more years in the same line of work, especially with the same employer, signals stability. Even if your income is not extremely high, a long track record can reassure an underwriter.
- **Large cash reserves.** Having several months of mortgage payments in liquid savings after closing shows you can weather an emergency. This can offset concerns about credit history or high debt.
- **Demonstrated ability to save.** Bank statements that show consistent savings deposits over time tell a story of financial discipline, even if the credit report has a few blemishes.
- **Low housing payment history.** If you have been paying rent that is equal to or higher than the proposed mortgage payment, and you have a history of on-time rent payments, that shows you can handle the new payment.

These factors do not work alone. An underwriter will look at the whole picture. A single strong factor might not be enough to offset a major risk, but several moderate factors together often are.

How to present compensating factors in a manual underwriting file

Presenting compensating factors is not just about mentioning them. The underwriter needs documented evidence. Here are the practical steps a borrower can take.

First, gather bank statements that show a pattern of saving. Statements covering the most recent 12 months are best. If you have been putting money into a savings account or a retirement account regularly, highlight those deposits. An underwriter can see that you manage your cash flow well.

Second, prepare a thorough letter of explanation for any credit issues. If a late payment happened because of a job loss or a medical event, explain the circumstances and show that the situation has resolved. Attach supporting documents like a return-to-work letter or proof of income recovery.

Third, document your employment history carefully. A resume or a written verification from your employer can help. If you have been in the same industry for years but changed jobs

recently, explain the move and show that your income is stable or increasing.



Finally, calculate your residual income using the VA's residual income guidelines. If your residual income is well above the minimum, include that calculation in your file. The underwriter will appreciate seeing the math laid out clearly.

scarpero.com offers resources that help veterans understand these steps and prepare a stronger application. Knowing what an underwriter looks for is half the battle; the other half is having the documents ready.

What compensating factors cannot fix

Compensating factors have limits. They cannot overcome a complete lack of ability to pay. If your income is too low to cover the mortgage and your other debts, no amount of savings or job stability will change that arithmetic. They also cannot fix a pattern of serious credit problems that has not been resolved. A recent foreclosure or bankruptcy will need time and rebuilt credit before most underwriters can approve a new loan.

Another common misconception is that compensating factors can replace a down payment. The VA loan program does not require a down payment in most cases, but if a lender's overlay requires one, compensating factors may not override that. It depends on the lender's own guidelines. Always ask your lender what their specific requirements are.

Finally, compensating factors are not a guarantee. Manual underwriting still involves human judgment, and different underwriters may weigh factors differently. That is why it helps to work with a lender who has experience with VA manual underwriting and knows how to present a file in the best light.

What this means for you as a borrower

If your VA loan application gets a Refer result from automated underwriting, do not assume the loan is dead. A Refer simply means the file needs manual review, and that review can succeed if you have compensating factors to support it. The key is to prepare your documentation ahead of time and understand what an underwriter will look for.



Start by reviewing your own financial picture. Calculate your residual income. Look at your bank statements for savings patterns. Write down your employment history and any explanations for credit events. Gather these items before you apply, so you are ready if the automated system sends your file to manual review.

The manual underwriting process is more time-consuming than automated approval, but it also gives you a chance to tell your story. Compensating factors are the evidence that supports that story. With the right preparation, a Refer result can become an approval.