VA Guidelines vs. Lender Overlays: What Actually Denies Your Loan

Two Sets of Rules, One Denial Letter

When a mortgage application falls through, the denial letter often blames a single reason: debt-too-high, credit-score-too-low, or insufficient income. But for veterans using a VA-backed loan, that one reason can come from two completely different rulebooks. One is the VA's own minimum requirements, set at the federal level. The other is a set of stricter standards that individual lenders add on top, commonly called lender overlays. Understanding which set of rules triggered the denial is the first step toward getting back on track.

Many borrowers assume that if they meet the VA's published guidelines, they are guaranteed approval. That is not how the system works. Lenders are private companies, and each one decides how much risk it is willing to take. A lender can accept the VA's minimums or demand higher scores, lower debt ratios, or more cash reserves. When a lender says no, the real question is whether the denial came from the VA's own rules or from that lender's overlays. The answer determines your next move.



What the VA Actually Requires

The Department of Veterans Affairs sets a baseline for every VA-guaranteed loan. Those guidelines are surprisingly flexible compared to conventional loan rules. There is no minimum credit score set by the VA itself, though most lenders will not go below a certain threshold. The VA does not require a down payment, and it allows debt-to-income ratios that can go higher than what Fannie Mae or Freddie Mac permit. The VA also permits a second mortgage under certain conditions, and it does not penalize borrowers for having had a previous short sale or foreclosure if enough time has passed and the circumstances were beyond their control.

These baseline rules are designed to give veterans a fair shot at homeownership, especially those who might have had financial setbacks after military service. The VA's underwriting standards focus on residual income, meaning how much money a borrower has left each month after paying major debts and housing costs. That focus can work in a veteran's favor even when the credit score is not perfect or the debt ratio looks high on paper.

What Lender Overlays Add

Lender overlays are the extra requirements that a mortgage company imposes on top of the VA's minimums. They exist because the lender is the one putting up the money, and it wants to protect itself from loans that might default. Overlays can be mild, like requiring a 620 credit score when the VA has no floor, or they can be strict, like demanding a 640 minimum, lower debt-to-income caps, or a waiting period after a bankruptcy that is longer than the VA requires.

Overlays are not published in one central place. Each lender sets its own, and they can change with market conditions. When the economy tightens, lenders tend to raise their overlays. When things are loose, they may relax them. This means a veteran who is denied by one lender might be approved by another that uses fewer overlays. The denial reason on the adverse action notice might look identical in both cases, but the underlying standard that caused it could be different.



How to Tell Which One Hit You

The adverse action notice that arrives after a denial must state the reason, but it rarely says whether that reason came from VA guidelines or a lender overlay. To find out, you need to ask the loan officer directly. Some loan officers will explain that the denial was based on their company's internal policy, not the VA's rules. Others may not make that distinction on their own.

You can also compare the denial reason against the VA's published guidelines. If the denial cites a credit score below 640, check whether the VA actually requires a 640. It does not. If the denial says your debt-to-income ratio is too high, find out what the VA considers acceptable. The VA typically allows ratios up to 41 percent, and sometimes higher with compensating factors. If your ratio is 45 percent and you were denied, that is likely an overlay issue.

A second opinion from another lender is one of the most practical steps you can take. A different lender may use different overlays, and their underwriting decision could come out differently. Even if the second lender also denies you, the conversation will help you understand whether the problem is something you can fix or a mismatch between your profile and that lender's risk appetite.

For veterans who need clear guidance on navigating this confusion, speaking with someone who specializes in VA loans can make a real difference. Carlos Scarpero, VA Mortgage Specialist, NMLS 1674385 focuses on helping veterans understand these exact distinctions and find a path forward after a denial.

When the Denial Is a VA Rule Issue

If the denial is actually based on a VA guideline, the fix is different. VA rules are not flexible on certain points. For example, the VA requires that a borrower not have a foreclosure on their record within the past two years. That is a hard rule with no overlay to blame. Similarly, the VA requires that the property meet minimum property requirements, which can cause a denial if the home inspection reveals significant safety or structural issues.

When the denial stems from a VA rule, the options are more limited. You may need to wait until a certain period has passed, or you may need to address the property condition before reapplying. But even then, a second opinion can help. Sometimes a lender misinterprets a VA rule or applies it more strictly than necessary. A second underwriter might see the same file and approve it.



What to Do with the Denial Reason

Once you know whether the denial came from VA guidelines or a lender overlay, you can decide what to do next. If it is an overlay issue, the simplest solution is to find a lender that uses fewer overlays. Not all lenders are the same. Some community banks and credit unions that specialize in VA lending tend to stay closer to the VA's baseline. Large national lenders often have more overlays because they are managing risk across a huge portfolio.

If the denial came from a VA rule, you may need to work on the underlying issue. That could mean paying down debt, waiting for a credit event to age, or finding a different property. In either case, do not assume that one denial means you cannot get a VA loan at all. The denial letter is specific to that lender, that property, and that moment in time. Change any one of those variables, and the outcome can shift.

Common Overlays That Trip Up Veterans

Some overlays show up more often than others. Here are a few that frequently cause denials for veterans who otherwise meet VA standards.

- **Credit score minimums**: Many lenders require a 620 or 640, even though the VA has no such floor. A score of 600 might still qualify with the right lender.

- **Debt-to-income ratio caps**: The VA allows up to 41 percent and sometimes higher. Some lenders cut off at 45 percent or even 43 percent, regardless of compensating factors.
- **Waiting periods after bankruptcy or foreclosure**: The VA requires two years after a foreclosure and two years after a Chapter 7 discharge. Some lenders demand three or four years.
- **Cash reserve requirements**: The VA does not require cash reserves for most purchase loans. Some lenders want two or three months of mortgage payments in the bank.

Knowing these overlays helps you ask better questions. When a lender says no, ask whether the denial is based on their overlay or the VA's rule. If they cannot answer clearly, that is itself a reason to seek a second opinion.

The Role of the Credit Report

The credit report is often where overlays and VA rules collide. A single error on a credit report can trigger a denial under either set of rules. VA guidelines require that the lender review the credit report and address any significant issues, but they do not require a perfect score. Lender overlays, on the other hand, may demand a minimum number of trade lines or a specific mix of credit types.

If your denial reason mentions credit history, pull your credit report and check it for errors. Disputing a mistake can raise your score enough to clear a lender's overlay threshold. Even if the error does not change the VA's view of your file, it might be enough to get you past the lender's internal cutoff.



One Lender's No Is Not the Final Word

The mortgage process can feel like a black box, especially after a denial. But the system is not as rigid as it appears. VA guidelines leave room for judgment, and lender overlays vary widely. A veteran who is turned down by one lender may have a completely different experience with another. The key is understanding which rulebook caused the denial and then matching your application to a lender whose overlays fit your profile.

For veterans who want a clearer view of the process and a partner who understands both VA rules and lender overlays, working with a specialist can be a smart move. **Carlos Scarpero, VA Mortgage Specialist, NMLS 1674385** works with veterans to identify the real reason behind a denial and find a lender whose standards align with the borrower's situation. That kind of targeted guidance often makes the difference between giving up and getting approved.