CREDIT PREP REPORT

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WHAT IS A CREDIT SCORE?

A credit score is a three-digit number that gives lenders an idea of your "creditworthiness." In other words, if you want to take out a loan or open a new credit account, lenders look at this number as an indicator of how risky it would be to lend you money.

The idea is that your past credit history can be used to predict how you will behave in the future.

It makes sense when you look it from the lender's perspective—if you didn't pay your credit card bill last month, then there's a bigger possibility that you won't pay it next month either. Similarly, if you have a history of always paying your bills on time, then lenders can reasonably assume that you will continue to do so.

As you can imagine, your credit score is incredibly important when you are trying to qualify for a home loan. You are asking a bank to lend you tens to hundreds of thousands of dollars. Before they give you the loan, they want to evaluate if you are likely to keep your promise to pay it back. That's why your credit score can be the reason you do or not get approved for the loan.

Now, you may have less than stellar credit and still get your loan approved. However, because you are seen as a risky borrower, the lender may decide to charge a higher interest rate on the loan. They're saying, "OK, we're taking a bigger risk lending you this money, so we want to get paid more money each month to make that risk worth our while." In that case, it's great that you can get a loan. It isn't so great that you will be paying thousands of dollars more over the life of the loan, simply because your credit score isn't high enough.

The good news is that you can clean up your credit and raise your score BEFORE you apply for a loan, giving yourself a better shot at qualifying for a loan with a lower interest rate.

WHAT DOES YOUR CREDIT SCORE MEAN?

Your credit score isn't pulled from out of the blue. It is calculated based on 5 main factors. Each factor accounts for a certain percentage of your score:

1. **Payment History = 35%**

   Do you pay your bills on time, or have you missed some? Paying even one bill 30 days late can drop your score 50 points, so this factor is a biggie.

2. **Amount Owed = 30%**

   This is the number of accounts you have and what their balances are. This can also be referred to as your "debt utilization ratio," meaning how much of your total available credit you are using. For example, if you have a credit card with a $10,000 limit and you have a $5,000 balance, your debt utilization ratio would be 50%. You want to keep this number below 30%, if possible.

3. **Length of Credit History = 15%**

   The older your accounts, the better. If lenders see that you have opened several new accounts recently, they may think that you are having cash flow problems or that you are planning on taking on a lot of new debt.

4. **Types of Credit In Use = 10%**

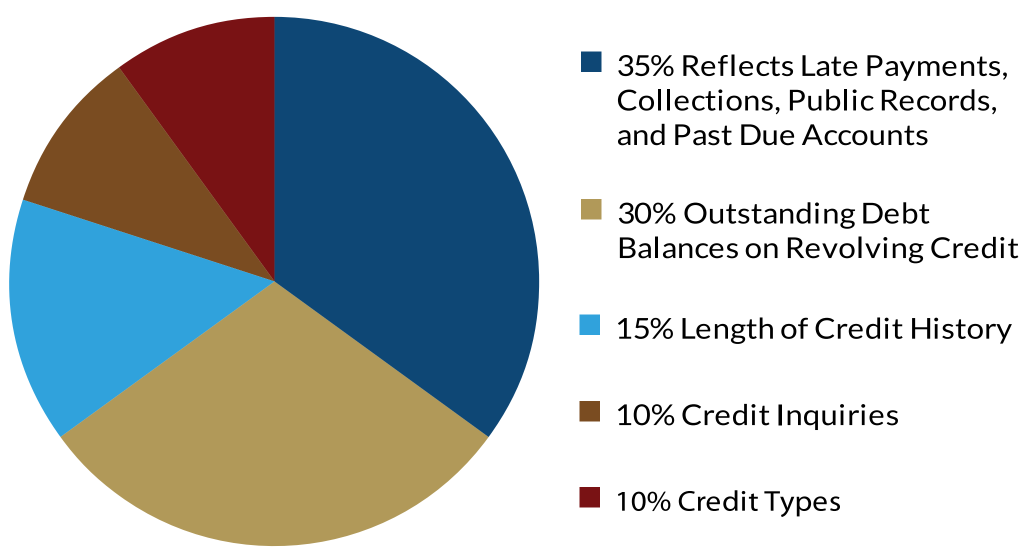
   Lenders like to see that you have a mix of different types of credit. This means that you don't have a combination of different credit accounts, such as a credit card, a car payment, and a student loan. This is a small factor of your score, so there's no need to open up a bunch of new credit accounts just show that you have different types of credit.

5. **New Credit = 10%**

   This includes new accounts that you have recently opened, as well as inquiries made on your credit report. An inquiry occurs when you give a lender permission to check your credit when you apply for a new account, such as when a car dealership runs your credit to see if you qualify for auto financing. Having a lot of inquiries can make lenders think you are planning to take on a lot of new debt, or that you have been denied credit from several places and are shopping around for some one who will approve you.

The credit bureaus use all of these factors in your credit history to generate your credit score, sometimes referred to as your FICO score. You will generally have three reports and three scores, one each from the three credit reporting agencies: TransUnion, Experian, and Equifax.

Credit scores can range from a low 300 to a high of 850 points. The higher the score, the lower the risk of default. That's why credit scores are often described as a "snapshot" of your credit profile at the particular point in time that your credit report is obtained.



Your credit report, if ordered by the consumer, is usually divided into several sections:

- Summary of Account Activity
- Detailed Account Information
- Credit Inquiries
- Negative Information
- Personal Data
- Dispute File Information

- Summary of your Rights Under the Fair Credit Reporting Act
- Information Regarding Identity Theft
- Your Rights Under State Law.

When applying for a mortgage loan, you must have at least a 24-month credit history. Lenders require at least one credit score per borrower, but some may require more. Each loan program and lender will have different credit history requirements, but a good rule of thumb is to have 3 accounts that have been open for at least 12-24 months.

HOW DO YOUR CREDIT HISTORY/SCORES AFFECT YOUR MORTGAGE?

You're sitting across the desk from a lender and they're about to pull a credit report. You find yourself beginning to sweat as you wait for the number that may change your life. Will it be good news or bad news? And what's even more concerning, it seems like every creditor has their own definition of what they consider "good vs. bad" credit, so how are you supposed to know?

Your credit scores, in today's mortgage environment, play a big role in your ability to be approved, the products that may be available, and the pricing of your loan's interest rate and fees.

Lenders will usually take a positive view of individuals with a good mix of credit accounts—car loans, credit cards, mortgages, etc.—that have a record of timely payments. However, a high debt to credit limit ratio (over 38%) will be closely reviewed for additional credit risk. No credit or few open accounts (less than 3 open accounts) will also increase your credit risk.

Usually, it's a good practice to keep your oldest credit account open even with a zero balance. Your "Age of Accounts" is calculated as an average. Let's say that you have 3 credit accounts. One is 10 years old, one is 5 years old, and one is 3 years old. The average of all of those is 6, which would be used your age of accounts. A high average account age generally demonstrates that you are financially stable. That's why it's a good idea to keep your oldest accounts open, even if you don't really use them anymore.

If you have a new or shorter credit history, don't go rushing out to open a bunch of new ones. Opening too many new accounts will lower your average account age and can have a huge negative impact on your score.

Late payments, collection accounts, and public records like tax liens and bankruptcies will seriously bring your score down.

For home loan purposes, your lender will use the middle score of the three scores submitted for loan qualification and pricing purposes. If you are applying for joint credit, the lender will use the lower of the two middle scores for pricing.

Lenders are very credit score focused in today's mortgage environment and a low credit score or even a less than stellar credit history is a major hot button. In some cases, I've seen people end up paying up to 1.50% higher interest rate than needed at the last minute, because they didn't do their homework by reviewing their credit history BEFORE they apply for credit and making any necessary fixes.

Here are some red flags to look for in order of severity:

- 30-day late payments
- 60-day late payments
- 90-150 day late payments
- Collections
- Judgments
- R-9 or uncollected charged-off items
- Loan modifications and short sales
- State and Federal tax liens
- Foreclosure
- Bankruptcy

Severity, how recent, and frequency of delinquencies noted on trade lines listed on the report within the last 24 months is a primary indicator of risk. Check the date of filing, the more recent the date, the harder the hit will be to your credit score.

How many trade lines have balances reported close to the high credit limit? Balances higher than 35-50% of the credit limit on revolving accounts generally indicate a higher risk and will result in a lower score. Lenders will especially be concerned when it is coupled with a lack of cash reserves for emergencies.

More than 8 credit cards are considered higher risk. Do not close out accounts unless one of the top key factors or reason codes indicates "too many bank cards." Closing an account, which has a zero balance and has been open for a long period of time, may negatively affect your score. A good mix of accounts (credit cards, auto, and mortgages) and a longer history will improve your score.

Multiple inquiries can potentially take 1-50 points off a consumer's score, depending on the other variables in the report. The average is 1-35 points, but be aware, there is no specific value.

Try to reduce or eliminate the need for credit inquiries about 6 months prior to obtaining a home loan. It will speed up the credit approval process and reduce the need for supportive documentation.

If your negative credit is confined to particular period of time due to an illness or job loss, as an example, take the time to file a consumer statement with the credit reporting agencies. It will become a permanent part of your credit record and will be something that lenders can look at prior to make a credit decision.

There are standard **"waiting periods"** for certain negative credit based on severity and loan type:

Conventional Loans

- **Chapter 7 Bankruptcy**: 4 years from the discharge date or dismissal date.
- **Chapter 13 Bankruptcy**: 2 years from discharge date or 4 years from dismissal date.
- **Multiple Bankruptcy Filings in the last 7 years**: 5 years from the latest discharge date or dismissal date.
- **Foreclosure**: 7 years from completion date and title transferred by to lender.
- **Deed-in-lieu of Foreclosure, Pre-foreclosure, Short Sale, or Prior Loan Modification**: From date the sale closed, title transferred to new owner or back to lender, or modification completion date. 4 years with no loan-to-value restrictions to program guidelines.
- **Consumer Credit Counseling**: 1 year payout has elapsed, payments made on time, with automated underwriting system approval through Fannie Mae or Freddie Mac.
- **Jumbo Loans**: Follow requirements specific to the proposed loan product.

FHA Loans

- **Chapter 7 Bankruptcy**: 2 years from the discharge date or dismissal date.
- **Chapter 13 Bankruptcy**: 1 year payout has elapsed with all payments made on time and permission obtained from court for new mortgage. No waiting period if discharged or dismissed.
- **Foreclosure and Deed-in-lieu of Foreclosure**: 3 years from completion date and title transferred by to lender.
- **Pre-foreclosure and Short Sale**: From date of credit approval for the new loan: No wait time if mortgage and installment debt was paid on time in the 12 months prior to the sale. 3 years if mortgage or any installment debt was in default at time of sale.
- **Prior Loan Modification**: No wait period if no late payments in the year prior to completion of the modification and no principle reduction. If late payments in the prior year or there was a principle reduction, the wait time is 3 years from completion date.
- **Consumer Credit Counseling**: 1 year payout has elapsed, payments made on time and agency permission for a new mortgage.

Federal VA Loans

- **Chapter 7 Bankruptcy**: 2 years from the discharge date or dismissal date.
- **Chapter 13 Bankruptcy**: 1 year payout has elapsed with all payments made on time and permission obtained from court for new mortgage. No waiting period if discharged or dismissed.
- **Foreclosure and Deed-in-lieu of Foreclosure**: 2 years from completion date and title transferred by to lender.
- **Pre-foreclosure, Short Sale, and Prior Loan Modification**: 2 years from credit approval date to date of sale closed and title transferred to new owner or the modification completion date.
- **Consumer Credit Counseling**: 1 year payout has elapsed, payments made on time and agency permission for a new mortgage.

USDA Loans

- **Chapter 7 Bankruptcy**: 3 years from the discharge date or dismissal date.
- **Chapter 13 Bankruptcy**: 1 year payout has elapsed with all payments made on time and permission obtained from court for new mortgage. No waiting period if discharged or dismissed.
- **Foreclosure and Deed-in-lieu of Foreclosure**: 3 years from completion date and title transferred by to lender.
- **Pre-foreclosure, Short Sale, and Prior Loan Modification**: 3 years from credit approval date to date of sale closed and title transferred to new owner or the modification completion date. Minimum of 660 credit score required.
- **Consumer Credit Counseling**: 1 year payout has elapsed, payments made on time and agency permission for a new mortgage.

On all loan types, if a mortgage has gone through a previous modification or the lender offered a short payoff, it is **not** eligible for a refinance.

Please note that shorter wait periods may be available under certain circumstances depending on the reason for the derogatory credit event. Ask your Loan Officer for more details. All mortgage products are subject to credit and property approval. Rates, program terms, and conditions are subject to change without notice and do change all of the time.

Recently, I have seen clients enter into seller financing arrangements so they could purchase a home while they were waiting out the standard "Waiting Periods." Most of the time, seller financing is for a short period of time and may contain a balloon-payment or refinance requirement in the first few years of the loan. This is not a good idea! With the change in waiting periods on several different loan types that took place August 16, 2014, consumer NOW have longer waiting periods than previously required. Some of these individuals are now faced with balloon payments or properties that they cannot refinance and may end up in foreclosure or a short sale situation AGAIN which will continue to affect they credit and ability to buy for years to come.

ITEMS THAT WILL NEED ATTENTION

Collections, Judgments, and Tax Liens

Generally, lenders will require unpaid collections, judgments, and tax liens to be paid prior to closing on a mortgage. However, small collections may be allowed to remain if they are a disputed account, medical account, and have a total amount owed, whether one or multiple accounts, of less than $2000. This aggregated amount will vary with loan product and requires an automated agency underwriting approval. It's the responsibility of the Underwriter to document the reason for approving a mortgage when the borrower has open collection accounts or judgments.

Judgments will almost always be required to be paid prior to closing on a new loan. There can be an exception to this policy if there is an established payment plan in place, but these type of exceptions are rare.

An Underwriter will look at State and Federal tax liens with great concern. The potential for additional liens against the subject property would increase the risk to the lender and jeopardize their lien position. The applicant must explain the reasons for the tax lien, pay them off, and provide evidence of release of lien prior to closing. No exceptions will be given to this guideline.

Lawsuits

When an applicant discloses that they are a party in a law suit or a pending lawsuit appears on the credit report or title report, it is essential for the lender to determine the extent of the applicant's exposure. An explanation of the lawsuit including whether the applicant is the plaintiff or defendant, the amount of the lawsuit and potential damages which may be awarded, and the extent to which the applicant is covered by insurance and potential out-of-pocket expenses should the lawsuit Is lost.

Student Loans

Delinquent student loans are not forgiven through bankruptcy and can literally trash a borrower's credit throughout their entire life. They must be paid as agreed and in good standing to qualify for mortgage financing. Even student loans that are in deferment will have any impact on your ability to borrower. A worst case monthly payment will be calculated for qualifying purposes. Loans that are in an income based repayment plan may also be required to be included in the debt to income ratio at a rate higher than the borrower is presently paying. Rules and guidelines will vary based on loan program, so it is important to ask your lender prior to pre-approval so there are no surprised at the last minute.

Documenting Previous Mortgage History

The credit report must be reviewed to determine the status of all mortgage accounts for the preceding 12 months. If the borrower has had a 30-day late payment or greater in the last 12 months, the borrower is not eligible for financing until that waiting period has elapsed.

FIVE STEPS TO HEALTHIER CREDIT...

1. Get the facts! Make sure that the data (i.e. mailing address, social security numbers, employers, spelling of name or former names are all spelled correctly.)
2. Dispute or correct errors 3 to 6 months prior to shopping for a mortgage.
3. Identify problem areas and work to make them better.
4. Follow up to make sure things are corrected appropriately with creditor or credit bureau.
5. Monitor your credit annually.

HOW DOES YOUR CREDIT SCORE RANK?

Credit Scores 740 or greater: Excellent Credit—Ranking 1

Credit Scores 700 to 739: Good Credit—Ranking 2

Credit Scores 660 to 699: Average Credit—Ranking 3

Credit Scores 620 to 659: Less than Average Credit—Ranking 4

Credit Scores less than 619: Poor Credit—Ranking 5

If you have a Ranking of 1 or 2, you have a strong credit history and shouldn't face any major issues in the mortgage approval process. Just due your due diligence and check your credit report to ensure accuracy at least 3 months before applying.

If you have a Ranking of 3 or 4, you have some red flags that may need to be addressed during the mortgage process. Take action to correct identified issues before applying for any mortgage to help make the process go smoother.

A Ranking of 4 or 5, you have some serious red flags and need to take specific action steps before applying for any mortgage to help improve your ability to borrower and avoid **large** rate and fee increases!

In addition to overall risk and negative underwriting impact, there are also "add-ons" to pricing for items such as credit score, loan purpose, cash-out refinance, loan to value, property type, and others. These add-ons can have a huge impact on your ability to borrow, as well as cost you thousands of dollars in unnecessary interest over the life of your loan.

Here is an example of typical "add-ons" to pricing for credit score!

Based on a 80% conventional purchase or rate/term refinance, greater than 15 years with a 1% Loan Origination Fee. This example is based on market conditions and can change without notice.

Credit Score greater than 740 = a plus .25% add-on to the Loan Origination Fee

Credit score 720 to 739 = a plus .50% add-on to the Loan Origination Fee.

Credit Score 700 to 719 = a plus 1.00% add-on to Loan Origination Fee.

Credit Score 680 to 699 = a plus 1.50% add-on to Loan Origination Fee.

Credit Score 660 to 679 = a plus 2.75% add-on to Loan Origination Fee.

Credit Score 640 to 659 = a plus 3.25% add-on to Loan Origination Fee.

Credit Score 620 to 639 = a plus 3.25% add-on to Loan Origination Fee.

Credit scores less than 619 = not eligible for conventional conforming loan

So you can see in this example that a borrower could end up paying as much as 3.25% in additional fees depending on the credit score. In most cases, it's not cost effective to pay these additional fees, so the lender will raise the interest rate to compensate for the additional fee making it really difficult for the borrower to actually understand what they are paying and the effect their credit score has had on their overall buying power.

WAYS TO RAISE YOUR OVERALL LENDER CREDIT READINESS

1. Develop habits that promote good credit like making payments on time
2. Monitor all three credit reporting agencies on an annual basis
3. Research alternative lending sources to help re-establish your credit history
4. Explain one-time digressions with a consumer statement
5. Create a savings account. Larger down payments are a positive motivator to a lender as it helps to reduce the overall credit risk.