

Mortgages and Credit Reports

Many home buyers are very worried about how their credit report will affect their ability to buy a home. We even heard one story that an applicant was denied a mortgage because he had returned a rented videotape late!

Of course, that could never happen. Most people will not need to worry about the effects of their credit history during the mortgage process. However, you can be better prepared if you get a copy of your credit report to review before you apply for your mortgage. That way, if there are any errors you can take steps to correct them before you make your application.

If you have had credit problems, be prepared to discuss them honestly with a mortgage professional and come to your application meeting with a written explanation. Responsible mortgage professionals know there can be legitimate reasons for credit problems, such as unemployment, illness or other financial difficulties. If you had a problem that's been corrected, and your payments have been on time for a year or more, your credit may be considered satisfactory.

ABC's of Mortgage Credit

The mortgage industry tends to create its own language and credit rating is no exception. BC Mortgage lending gets its name from the grading of one's credit based on such things such as payment history, amount of debt payments, bankruptcies, equity position, credit scores, etc.

We have compiled a guide to help you estimate your credit grade. This is only a guide as many companies have exceptions that may result in more strict or more lenient guidelines.

- A+ 720-850
- A 620-719
- B 590-619
- C 560-589
- D 530-559
- E 500-529

The figures shown here are estimates. When trying to figure your credit grade, keep in mind the following principles:

- Other Things Being Equal-When you have derogatory credit, all of the other aspects of the loan need to be in order. Equity, stability, income, documentation, assets, etc. play a larger role in the approval decision.
- Worst Case Scenario-When determining your grade, various combinations are allowed, but the worst case will push your grade to a lower credit guide. Mortgage Lates and Bankruptcies are the most important.
- Going Once, Going Twice-Credit patterns are very important. A high number of recent inquiries and more than a few outstanding loans may signal a problem. A "willingness to pay" is important, thus late payments in the same time period is better than random lates as they signal an effort to pay even after falling behind.

Credit Guide Scoring

In a nutshell, credit scoring is a statistical method of assessing the credit risk of a loan applicant. The score is a number that rates the likelihood an individual will pay back a loan. The score looks at the following items: past delinquencies, derogatory payment behavior, current debt level, length of credit history, types of credit, number of inquiries.

Credit scoring will place borrowers in one of three general categories.

First, a borrower with a score 680 and above may be considered an A+ loan. The loan will involve basic underwriting, probably through a "computerized automated underwriting" system and be completed within minutes. Borrowers falling into this category may have a good chance to obtain a lower rate of interest and close their loan within a couple of days.

Second, a score below 680 but above 620 may indicate underwriters will take a closer look at the file in determining potential risks. Borrowers falling into this category may find the process and underwriting time no different than in the past. Supplemental credit documentation and letters of explanation may be required before an underwriting decision is made. Loans within this FICO scoring range may allow borrowers to obtain "A" pricing, but loan closing may still take several days or weeks as it does now.

Third, borrowers with a score below 620 may find themselves locked out of the best loan rates and terms offered. Mortgage professionals may divert these borrowers to alternate funding sources other than FNMA and FHLMC. Borrowers may find the loan terms and conditions less attractive than the "A" loans, and it may take some time before a suitable funding source is located.

As more companies utilize credit scoring, the loan approval and closing time will be compressed for most consumers. In the future, a high FICO score may be your ticket to a speedy and competitively priced mortgage loan.

Credit Reporting Agencies

Equifax

PO Box 105873
Atlanta, GA 30348
(800) 685-1111

National Consumer Assistance Center

PO Box 2002
Allen, TX 75013

Consumer Credit Questions

888 EXPERIAN (888 397 3742)

Trans-Union

PO Box 390
Springfield, PA 19064
(800) 916-8800
(800) 851-2674

How to Correct Errors **TOP**

You have the right, under the Fair Credit Reporting Act, to dispute the completeness and accuracy of information in your credit file. When a credit reporting agency receives a dispute, it must reinvestigate and record the current status of the disputed items within a "reasonable period of time," unless it believes the dispute is "frivolous or irrelevant." If the credit reporting agency cannot verify a disputed item, it must delete it. If your report contains erroneous information, the credit reporting agency must correct it. If an item is incomplete, the credit reporting agency must complete it.

For example, if your file showed that you were late in making payments on accounts, but failed to show that you were no longer delinquent, the credit reporting agency must show that your payments are now current. Or if your file showed an account that belongs only to another person, the credit reporting agency would have to delete it. Also, at your request, the credit reporting agency must send a notice of correction to any report recipient who has checked your file in the past six months.

For those items in your credit profile which you feel deserve further explanation (such as an account that was paid late

due to the loss of job, military call-up, or unexpected medical bills), you may send a brief statement to the appropriate credit reporting agency. The information will be placed on your credit profile and will be disclosed each time your credit profile is accessed.

Credit Profile

A Credit Profile refers to a consumer credit file, which is made up of various consumer credit reporting agencies. It is a picture of how you (as an individual) paid back the companies you have borrowed money from, or how you have met other financial obligations.

There are usually five categories of information on a credit profile:

1. Identifying Information
2. Employment Information
3. Credit Information
4. Public Record Information
5. Inquiries

Credit Report Access

The Fair Credit Reporting Act (FCRA) outlines specifically who can see your credit profile. Businesses must have a "legitimate business need," and a "permissible purpose," as stated in the federal law to obtain your credit file. Otherwise, only you, and only those who you give written permission, can access your credit files. Your neighbors, friends, co-workers, and even your family members cannot have access to your credit profile unless you authorize it. Some examples of those who can access your credit files are:

- Credit grantors
- Collection agencies
- Insurance companies
- Employers

Any company that receives a copy of your credit profile will be listed under the "Inquiry" section of your report.

The Fair Credit Reporting Act (FCRA) is the federal law regulating credit reporting companies like Equifax, Experian, and Trans Union. It has been in effect since 1971. A revised FCRA became effective October 1, 1997. This law protects consumers' rights, such as the right to review and contest information in their credit profiles. It also specifically defines who can access the information in a credit profile, and how you are notified of this activity.

Credit Questions & Answers

Why do we need credit reporting?

Credit reporting is needed because it provides the information that helps consumers make purchases, secure loans, pay for college educations, and manage their personal finances. Credit reporting makes it possible for stores to accept your checks, banks to offer credit and debit cards, businesses to market products, and corporations to better manage their operations to benefit the world's economy.

What is a credit inquiry?

An "inquiry" is a listing of the name of a credit grantor, or authorized user who has accessed your credit file. Each inquiry is posted to the credit file so you know who has obtained a copy of it. Credit grantors post an inquiry before offering you a pre-approval credit card application. These are listed as "promotional" inquiries on your credit file because only your name and address were accessed, not your credit history information. They are NOT sent to credit grantors or businesses for reasons of credit reporting. They are listed for your informational purposes only.

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and Trans Union. It has been in effect since 1971. A revised FCRA became effective October 1, 1997. This law protects consumers' rights, such as the right to review and contest information in their credit profiles. It also specifically defines who can access the information in a credit profile, and how you are notified of this activity. You may obtain a copy the FCRA from the Federal Trade Commission.

How does divorce affect consumer credit?

A divorce decree does not supersede the original contract with the creditor, and does not release you from legal responsibility on any accounts. You must contact each creditor individually and seek their legal binding release of your obligation. Only after that release can your credit history be updated accordingly.

Should I use one of those companies that promise to help correct my credit?

It's your choice. However, beware of companies that promise to remove accurate information from your credit file. Accurate information cannot be removed from a credit file. There is nothing they can do for you that you cannot do for yourself by contacting the credit reporting agencies directly. Only time will heal a delinquent credit history.

What if an item on my credit profile is correct, but I disagree with it being reported?

For those items in your credit profile which you feel deserve further explanation (such as an account that was paid late due to the loss of job, military call-up, or unexpected medical bills), you may send a brief statement to the appropriate credit reporting agency. The information will be placed on your credit profile and will be disclosed each time your credit profile is accessed.

FICO Scores

FICO® scores were developed by Fair Isaac & Company, Inc. for each of the credit repositories. The scores are: (Equifax) Beacon®, (Experian formerly TRW) Experian/FICO and (TransUnion) Empirica®. They are simply repository scores meaning they only consider the information contained in a person's credit file; they do not consider a person's income, savings or amount of a down payment for a mortgage.

The scores were designed to assess risk. They are useful in directing applications to specific loan programs and to set levels of underwriting, i.e. streamline, traditional or second review. The scores are objective, consistent, accurate and fast.

Many people in the mortgage business are skeptical about the accuracy of FICO scores. Scoring has only been an integral part of the mortgage process in the past few years; however, the scores have been in use since the 1950's by retail merchants, credit card companies, insurance companies and banks for consumer lending. The data from large scoring projects emphasizes the accuracy, the predictive quality of the scores. Large portfolios have been scored for mortgage servicing and investment groups, and again, they demonstrate that FICO scores work.

The scores were developed from each repository's database using actual loan performance. A sample of over 750,000 consumers per repository was used. The repositories have each made great strides to increase the accuracy of their respective database through computer technology and internal monitoring. There is a new standard reporting format for credit grantors to use when sending electronic information to the repositories; this is the critical first step to providing accurate data.

The scores use a multiple scorecard design. Each repository uses 10 individual scorecards, and the models at each

repository are the same. This increases accuracy and optimizes the predictive variables for each subpopulation. (For example, a borrower with two 30-day late payments will be scored against a population with some minor delinquencies.) This feature may cause a borrower with delinquencies to score in the same range as a borrower without delinquencies. Scorecards are reviewed and updated every twenty-four months.

The actual scoring process is proprietary, and the algorithms are copyrighted. We can share the predictive variables, the portion of the credit file considered and the weight as provided by Fair Isaac. They are:

- Previous credit performance (35%)
- Trade line information specific to payment history
- Current level of indebtedness (30%)
- Current balance compared to the high credit
- Time credit has been in use (15%)
- Opening date
- Types of credit available (15%)
- Installment loans, revolving accounts, debit accounts
- Pursuit of new credit (less than 5%)

Inquiries

FICO has changed the way it factors credit checks, inquiries. These changes should minimize the "negative" effects that aggressive rate shopping or the normal mortgage process can have on a mortgage applicant. In the new Beacon version, the deduping process has been expanded beyond seven days. One variable counts the number of days within 365 days of scoring. If there has not been an inquiry, the deduping mechanism is not activated. If there is a consumer originated inquiry within the past 365 days from mortgage or auto related industries, these inquiries are ignored for the first 30 calendar days from scoring; then, multiple inquiries within the next 14 days are counted as one. Each inquiry will still appear on the credit report.

Scores should not change significantly because the variable in the model using inquiries contributes less than 5% of the predictive power of the model. According to Equifax statisticians, an average of 5% of the credit reports in the Equifax consumer credit reporting database (over 200 million consumer files) will see a change in score due to this. Fewer than 5% of those will see a change significant enough to effect a loan decision.

In order to get a score a borrower must have the following conditions in his/her file:

- No "Deceased" indicator on the credit file
- At least one undisputed trade line that has been updated in the last six months
- One trade line open at least six months

Scores range from 350 (high risk) to 850 (low risk). A scorecard of 660 will be 660 on Beacon 96, Empirica and Experian/FICO if the data on each file is the same. However, each repository is likely to contain different data.

Every score is accompanied by a maximum of four reason codes. Reason codes identify the most significant reason that a consumer did not score higher. They are not red flags. Consumers with scores in the 800 range get reason codes just as consumers with scores in the 500 range. The reason codes may be used in describing to the consumer the reason for adverse action. Scores are not part of the credit file and are not covered by the Fair Credit Reporting Act. Scores, if disclosed to the consumer, must be related to the credit file - using the reason codes - since the score has no meaning in itself; the meaning or risk level is assigned by the lender and the investor.

When applicants have erroneous information reported, document the inaccuracies. The easiest way to do that is to have your credit-reporting agency upgrade the merged in-

file to an edited mid-range report or to a Residential Mortgage Credit Report. With the upgraded report, you can ignore the score! The file will have to be handled in a traditional manner for underwriting and investment purposes. The developed report will provide the paper trail that investors want.