Credit:

KNOW THE SCORE

Educate your Customers about Guidelines and Critical Issues.

Credit scoring has an enormous impact on your client's financial picture. It can mean the difference between getting a good interest rate on their mortgage loan, or whether they even qualify at all. As a loan originator, it is imperative to be well-versed on the factors that influence your client's credit score, and have the ability to guide them to take simple, yet very important steps to clean up their credit or work with them to put them on the right path to obtaining an A-paper loan at some point the future.

We all know that good credit translates into lower rates for the consumer, but knowing how to work with a client who has a less than perfect score can make a big difference in the number of loans you fund each month. Take the initiative to know how to communicate the nuances of credit scoring to your clients, know how to work the system to their advantage, and have a plan in place to follow up on those deals that don't immediately fall into place for you.

The Five Factors

What the credit scoring model seeks to quantify is how likely the consumer is to pay off their debt without being more than 90 days late on a payment at any time in the future. Credit scores can range between a low score of 300 and a high of 850. The higher the client's score is, the less likely they are to default on their loan. Only a rare one out of approximately 1,300 people in the United States has a credit score of above 800. These are the slam-dunk clients who walk away with the best interest rates. On the other hand, one of eight prospective home buyers are faced with the scenario that they may not qualify for the loan they want because they have a lower score, between 500 and 600. Here is a simple chart to give you the tiering structure and what it means to the underwriter.

720 and over	Wonderful! You are at the top of the best rates and terms offered to you.
700-719	Excellent score. You are a very desirable borrower.
680-699 to	Good credit. You should be in good shape buy.
660-679	OK credit. Don't look for other exceptions.
640-659	Borderline. OK if everything else is strong.
620-639	Weak. The rest of your life must be perfect.
600-619	Difficult. Needs some work, or a special program.
Below 600	Trouble! Try to fix up your credit!

This score comprises five factors. I will list these in order of importance, just as your underwriter will look at the score:

Payment History: 35 percent impact. Paying debt on time and in full has a positive impact. Late payment, judgments and charge-offs have a negative impact. Missing a high payment has a more severe impact than missing a low payment.

Outstanding Credit Balances: 30 percent impact. The ratio marking the difference between the outstanding balance and the available credit is important here. Ideally, the client should keep their balance below 10 percent of the available credit limit.

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Credit History: 15 percent impact. This marks the length of time since a particular credit line was established. A seasoned borrower is stronger in this area.

Type of Credit: 10 percent impact. A mix of auto loans, credit cards, and mortgages is more positive than a concentration of debt from credit cards only.

Inquiries: 10 percent impact. This quantifies the number of inquiries that have been made on a consumer's credit history within a six-month period. Each hard inquiry can cost from two to 50 points on a credit score but the maximum number of inquiries that will reduce the score is 10. Eleven or more inquiries in a six-month period will have no further impact on the borrower's credit score.

One thing that is important to remember is that a computer that's not taking any personal factors into consideration calculates these scores. When you run a credit report, it is simply today's snapshot of the client's credit profile. This can fluctuate dramatically within the course of a week, depending on the client's own activities. Make your client aware of this when they enter into the loan process, and let them know that it's not in their best interest to go out on a shopping spree. They need to make sure they are not creating a negative impact on the score while the lender is reviewing it.

Secondly, explain that you are compiling a Tri-Merge Credit Report. This combines the scores provided by Fair-Issiac (FICO), with the score generated by TransUnion (Empirica) and the Beacon Score produced by Equifax. Let you client know you are providing the lender with the rounded profile because these three scoring systems can vary in their results. The lender is going to look at the middle score and throw out the other two. This is, in many cases, a benefit to the consumer.

Dealing with Challenges

Typically, a person with a bad credit score is in this position because they lack structure in their life. There are, or course, cases where health has been a factor, or perhaps there's been a layoff or fluctuation in employment, but for the most part, there are individuals who lack the discipline to pay their bills on time or curb their spending. You need to become the knight in shining armour who provides them with a simple roadmap to get back on the right track.

Now let's get into some examples that will help you deal with less than perfect credit scores on the fly. Let's say you have a client who needs to do a stated income loan, but they have a credit score of 664. They have a concentration of credit card debt on one card; let say $17,000 on a card with a $20,000 limit. At the same time, they have four or five additional credit cards, all with a zero balance. Advise the client to distribute the debt over the cards that are available to work with. This changes the ratio of debt to available credit and can cause the credit score to pierce through that magical threshold on our chart, and put them in the 680-699 category of having good credit.

Another thing to take into consideration in a case like this is the percentage that each of the five factors weigh in on the resulting credit score. Let's say you have a client with a credit high (the maximum debt allowance ce on all cards, combined) of $20,000. They have one card that is used for business purposes that is pushing the limit. Advise the client to get two new cards, each with a $5,000 limit, and once again, spread the debt out over the cards leaving a 30 percent margin of available credit on all the cards. Explain to the client, that yes, this will affect the factor of credit history, but this specific factor only affects the overall score by 15 percent. The big difference once again, is the resulting impact on the credit balance factor, which has a 30 percent influence on the overall score and can cause the overall calculation to pierce through the next level on our chart.

Conversely, advise your clients not to close any existing credit card accounts, even if they are at a zero balance. Some people think the are doing themselves a favour by having fewer cards, and they lose out on the credit history factor. Even if the client does not have a good rate on those old credit cards, they are rewarded for having the long-term credit history.

These are just a few examples of what you can advise your client to do while they are in the loan process. If they are disappointed by the fact that they cannot get the A-paper loan up front, let them know that you will be monitoring rates and their specific loan scenario on an ongoing basis and advise them when they will have the opportunity to turn this situation around. The new mortgage debt will temporarily drop the score, but once the first payment registers as "paid", the score will begin to go up again.

If you feel the client is in need of credit remediation, and especially if you live in an area where this is an overall problem within the population, you should seek to align yourself with a credible resource for credit repair. While government web sites will suggest that self-help may be the best option, keep in mind that these people, for the most part, have a discipline problem when it comes to spending and making payments. They are not likely to have the diligence to research and remedy their own credit problems.

The Federal Trade Commission regulates credit repair services, and they provide free information to help consumers spot, stop and avoid businesses with fraudulent, deceptive or unfair practices. Be familiar with the Credit Repair Organizations Act (www.ftc.gov/statutes/croa/croa.htm) as you seek out a genuine ally in this area. Research their background and make sure this company will cast a good reflection on you when you refer your clients to them. Follow up with your clients and let them know that you are on their side as a trusted advisor, constantly watching out for new options in their best interest and guide them on the road to good credit.

My team and I have set up a special link for you to provide more facts on increasing the credit score. Visit www.loantoolbox.com/go/creditscore to download this flyer and copy it to your own letterhead. This can serve as an outline when discussing credit issues with your clients on a daily basis.

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