BUILDING AND REPAIRING YOUR CREDIT

NO ASPIRATIONAL HOMEOWNER IS THE SAME, AND NEITHER ARE THEIR CREDIT SCORES.

Two people with the same number atop their credit reports could have wildly different financial histories. That's why, in some cases, applicants who thought they had plenty of "buying power" actually need help to achieve their homeownership goals.

This guide follows four basic "types" of everyday people who are in need of credit repair. You might identify with some of their situations. If so, we hope that character's story and victory can be yours, too. So...who are you?

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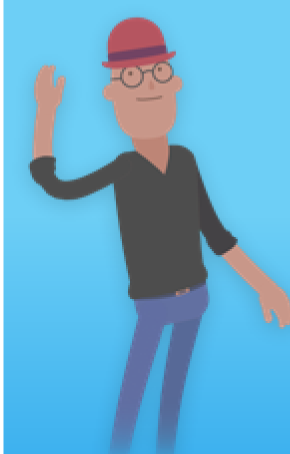
CARLOS



Bad Credit

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JOE

Low or No Credit

After graduating high school, Joe was more interested in the booming oil refining industry in his area than a four year degree. High paying jobs with long term security were available with only a two year degree in Operations. That's why Joe applied for a part-time day laborer job and enrolled in online classes. His parents were supportive and encouraged him to live at home so he could pay for his education.

Joe was quickly promoted to full-time Process Operator after he earned his degree. And since he dedicated most of his time to work—basically living at the refinery—he never moved out of his parents' place.

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Now, after living at home for two years, Joe realizes that he's saved up enough money to buy a home. But he hasn't proven himself capable of carrying debt: he has zero credit—he's been living at home, paid for his degree without taking out loans and never applied for a credit card.

Joe's situation is very common, in fact

26-MILLION AMERICANS ARE CREDIT INVISIBLE[1]

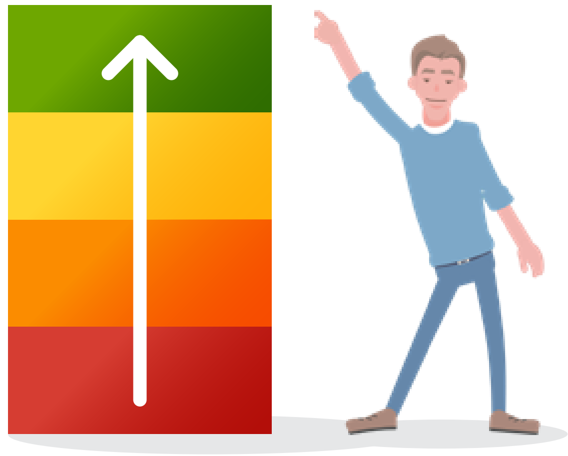
1 – OUT OF – 5 CONSUMERS

have no credit history or credit score[2]

Joe: Low or No Credit

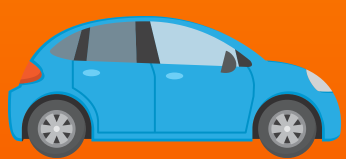
If Joe wants a loan, he has to build his credit score. The better his score, the better his interest rate will be. He'll also have more lending options and bargaining power as a consumer. When Joe visits a mortgage lender, he's told he has two options to go about buying his home.

Here's how Joe can make his homeownership dream come true:



OPTION 1

Joe uses his history of on-time car and medical insurance payments and cell phone payments as non-traditional tradelines.



He immediately applies for an ***FHA loan***, which is insured by the federal government.

Joe moves into his dream home and begins building his credit by making consistent on-time loan payments.

FHA loans: openmortgage.com/fha

- Help buyers with no or low credit scores
- Offer low down payments and secured interest rates
- Require mortgage insurance through the full term of the loan

OPTION 2

Joe decides to establish traditional ***tradelines***. He will save for a larger down payment and build his credit at the same time. He sets ***750*** as a credit score goal.

Joe: Low or No Credit

OPTION 2

To qualify for a mortgage, Joe should open three to five traditional ***tradelines*** (individual accounts on a credit report).

Types of tradelines

Revolving:

- Credit cards
- Lines of credit

Installment:

- Auto loans
- Student loans
- Personal loans

First, Joe applies for a ***secured credit card***. After some time, he also applies for a ***credit-builder loan***. Establishing a history of consistent on-time payments shows that he is a trusted borrower.

Secured Credit Card:

- Requires a refundable security deposit
- Credit limit is equal to the amount put down for the security deposit

Credit Builder Loan:

- Lenders place a loan balance into an account that is similar to a savings account
- Borrowers receive all of their money back when the loan is paid in full

Next, Joe asks his parents to make him an ***authorized user*** on one of their credit cards.

Authorized User:

Becoming an authorized user is a safer option that can allow a potential borrower to build their credit slowly by benefitting from the primary user's positive credit history.

Joe now has three credit lines, but he can apply for a standard credit card with a higher credit line in about a year. This will lower his ***credit utilization*** percentage and raise his credit score.

Credit Utilization:

- Utilization refers to how much credit that he's using
- If he has **$2,000 charged** to a card with a **$4,000 limit**, then he has a **50%** utilization rate, since half of the credit is being used

Joe applies for and receives a mortgage. He moves into a new home and continues building his credit by making consistent on-time loan payments.
The higher his credit score goes, the better his interest rates and options will be when he wants to buy a new car, take out a credit card, or maybe move into a bigger home.

DANA

High Debt-to-Income Ratio

Dana was excited to start her new career as a teacher. Since her starting salary was low, she supplemented her income with credit cards. She paid her bills on time, but not always in full. Credit cards are not her only debt—she also owes $15,000 in ***student loans***.

Dana wants to pay her student loan debt and save for a down payment, but at this point she can only afford the minimum monthly payments, which just cover accrued interest. Since she ***deferred*** her loans for a while after graduating, she now owes more than when she started paying them on an income-based repayment plan.

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Student Loans

Loan Deferment:

- A deferment is a suspension of payments for a period of time, varying by individual loan servicers or circumstances
- For that period, interest continues to accrue, however eligible borrowers don't have to pay anything towards their loans
- When the deferment period ends, the previous monthly required payments resume. The loan balance may be higher when it enters repayment

Income Based Repayment Plans (IBR):

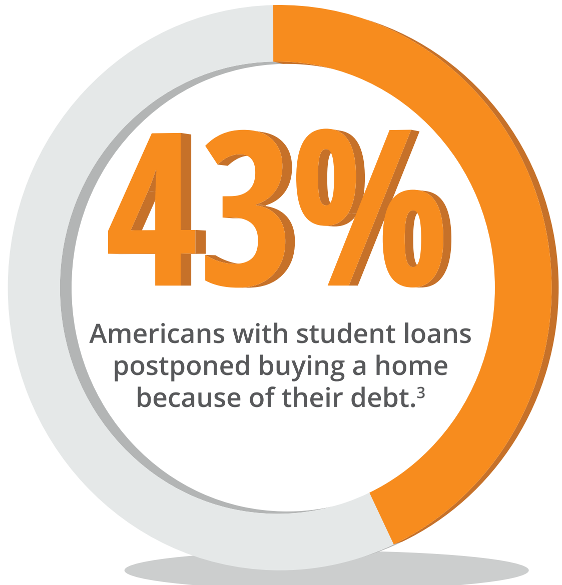
- These plans help borrowers pay back loans according to their income
- Established monthly payments are factored into borrowers' ***Debt-To-Income Ratio (DTI)***
- Lenders don't consider new, lower, income based repayment details
- Lenders might require borrowers to submit proof of income and tax documentation every year to continue eligibility

If Dana applies for a mortgage while her student loans are in deferment or ***IBR***, previously established monthly student loan payments are factored into her ***DTI***. A percentage of her total debt will be considered depending on what type of mortgage she applies for.

Dana: High Debt-to-Income Ratio

Dana has a high debt-to-income ratio, which is very common for people with student loans. When Dana goes to her mortgage lender, she is told she's currently ***ineligible*** for a loan.

Unfortunately, the only long term solution to handling her student loans is paying them off. Dana and her mortgage lender figure out a plan to lower her debt, raise her credit score, and ultimately help her purchase a nice starter home.



STEP 1

Dana figures out how much it will take per month to pay her debt off exactly X number of years from now. She continues to pay her bills on time.

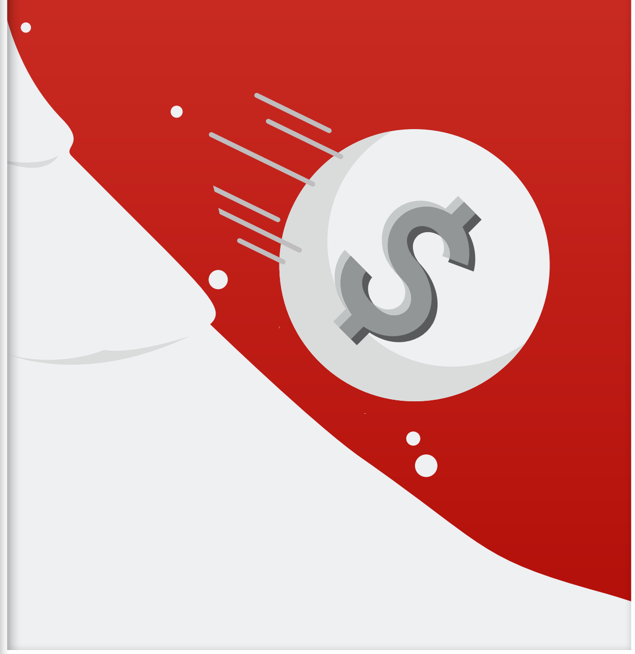
- She stays home most nights to save, putting all of the money saved towards her debt.

- She also works overtime in the summer to put more money towards her student loans.
- She applies for a 0% APR credit card that allows her to consolidate her remaining credit card debt and continue to pay down her balances, but without having to pay the additional interest rates of the other cards.
- When her debt is less than 38% of her income, that's the best time for her to apply for a mortgage.

STEP 2

Dana uses the snowball method to reduce her debt.

- She pays off her smallest balances first, paying the minimum on larger debts.
- When one account is paid off, the amount that was going to that loan then goes to the next largest loan, etc.
- When her debt is less than 38% of her income, that's the best time for her to apply for a mortgage.



CARLOS

Bad Credit

After graduating from technical school, Carlos landed a job as an aviation maintenance mechanic. This brought in a great salary, but since he never lived on his own before, he made financial decisions that weren't conducive to future homeownership.

Instead of living at home, Carlos rented an expensive apartment with a coworker. Paying rent on time is a sign of trustworthiness to lenders, but Carlos also took out a credit card and used it every time he went out with friends. Since he was working overtime a lot, he forgot to pay the bill on time. Late fees and interest started adding up, forcing him to take out another card to supplement his income.

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Many consumers aren't familiar with how daily routines affect their ability to buy a home. It's only after being denied for a car loan, mortgage, or even apartment lease that reality sets in. In this case, Carlos has maxed out several cards (and taken out new ones before paying off the old ones) to supplement his income. His high paying job can no longer cover his debt.

When Carlos decides to buy a home, the loan officer tells him that there's a medical collection attached to his credit report as well. Carlos had no idea that he owed that money. Carlos' lender tells him the longer Carlos goes without paying off his debts, the lower his credit score will sink. There are two ways he can pay off his debt and repair his credit.

Fixing your credit is a three-step process

1 ***Identify your problem accounts:***

- Carlos has too many credit cards and the utilization of each card is too high.

2 ***Add Points:***

- Carlos increases his score by lowering the credit utilization of every credit card below **30%**.
- He also uses the **snowball method** to pay off and close extra accounts that are impacting his score.

3 ***Delete Items:***

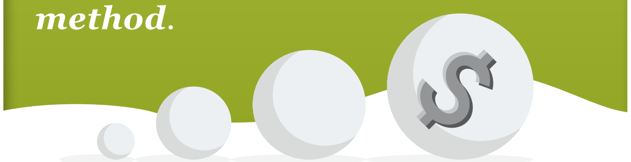
- Carlos removes the collection from his report by asking his health insurance company to pay the debt, as he had coverage when the bill came due.

Carlos: Bad Credit

OPTION 1

Carlos identifies that his most immediate and problematic accounts are his five ***retail cards***.

Carlos owes money on several accounts, so he has to be strategic. He starts to pay off his retail card balances, using the ***snowball method***.



He pays off three of his five retail cards and closes them. He keeps the oldest two cards since he has the longest history of credit through them.

Carlos continues to apply this method to his standard credit cards as well, driving down his credit utilization.

Retail Cards:

- Retail cards are store specific, usually offering additional perks like extra cashback or discounts.
- Borrowers wanting to improve their credit should have no more than 2 retail cards with utilization below 10%
- Retailers can close accounts if the card is not being used.

Snowball Method:

- Borrowers pay off their smallest balances first while paying the minimum on larger debts.
- When that account is paid off, the amount that was going towards that loan then goes to the next smallest loan, etc.

Properly Closing Out a Credit Card:

- All authorized users should be made aware the credit card is being closed
- Borrowers shouldn't assume the most recent statement balance reflects everything that is owed to that account
- There still may be fees and interest charges that will appear in the next billing cycle
- Borrowers should confirm the total amount owed and pay off the exact amount
- Request a letter from the card issuer that confirms the account was closed with a zero balance
- Finally dispose of the card

As Carlos pays off his debts and closes unnecessary accounts, he begins to rebuild his credit score. When he reaches a 750 credit score, he returns to his lender to apply for a loan.

OPTION 2

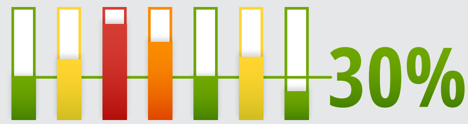
Carlos uses the ***utilization method*** to control his debt and get it into a more manageable space long term.

He creates a spreadsheet to determine which card balances are the highest. He pays down the account with the highest utilization to 30%, then moves on to the next.

As Carlos lowers his credit utilization, he begins to rebuild his credit score. When he reaches a 750 credit score, he returns to his lender to apply for a loan.

Utilization Method:

- Borrowers lower their utilization rate by paying down all accounts to below 30%.



- Anything higher than 30% utilization can:
  - ◊ Decrease credit score
  - ◊ Make lenders worry that borrowers have issues repaying new debt (i.e. a mortgage)
- Start by paying down the account with the highest utilization.
- This is the most effective and expedient way for borrowers to boost their credit score

Most lenders will not consider Carlos if he has a ***collection*** on his report—that is, with the exception of medical collections. Since Carlos is fully committed to making his credit as clean as possible, he commits to paying this collection while also selecting option 1 or 2 to lower his credit card debt.

Collections

Creditors typically update your credit report monthly. After a 180-day waiting period from when an account first becomes “Past Due,” a creditor marks the account as “in collection.” Since Carlos didn’t know about his bill, his failure to pay it clearly exceeded the 180 day limit, so a collection was placed on his credit report

Types of Collections:

- Medical Collections
- Delinquent student loan, credit card or utility bill payments
- Returned checks
- Unpaid, court-ordered childcare
- Money owed due to losing a lawsuit

Collections stay on credit reports for seven years. Making payments on a collection—even fully paying one off—usually does not affect the time it stays on your credit reports.

In Carlos’ case, because he is making an effort to pay his bill and can prove he didn’t know about the debt in the first place. It’s possible the credit bureau will remove the collection from his records, however he has to notify them and explain the situation.

Carlos should also write to the credit bureaus to inform them of his intent to pay off his medical collection and request it be removed from his report in return for payment. Below is a collection letter template for your personal use.

Collection Letter Template

Notify the credit bureaus that you were unaware of a collection on your credit report, and that you intend to pay the debt. In return, request that the collection be removed from your report.

Dear (collector),

I just reviewed my credit report and was surprised to learn I have a collection in the amount of $XXXX being reported by your company.

I was never informed of this in writing or over the phone.

I believe that it is required by law for you to notify me and provide me with disclosures within 5 days of your initial communication. I never received any notification or disclosures, which is a violation of the Fair Debt Collection Practices Act.

The debt is small enough that I am willing to pay it in exchange for the removal of its entry on my credit report. I don't think this is something that should have been reported and would have appreciated the opportunity to settle it before seeing a collection on my credit report. I would like to take care of this quickly and believe it would be easier for me to pay the amount due in exchange for the immediate removal of this collection from my credit report.

Sincerely,
(Consumer)

KATE

Bankruptcy

Kate was two years into her position at a high-paying tech firm when she found out her father had cancer. Treatment and recovery would be a full-time job for him and Kate's mother, leaving the family business unattended. Kate loved her career, but decided to take over the family business until her parents could return.

Kate discovered that the family business had been doing poorly for years. Since she moved back home, she doesn't take a salary and saves money for the business. She also takes out loans against the business and its building and uses personal credit cards for business expenses.

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The business keeps struggling. Now Kate and the business are in serious debt with only one way out: ***bankruptcy***. Kate has always dreamed of owning a home and knows this situation will have a long lasting effect on her credit. She visits a loan originator, who tells her to consult a bankruptcy attorney. While it's possible to file bankruptcy without an attorney, it is not recommended. After consulting with her attorney, Kate narrows her options down to either filing for Chapter 7 or Chapter 13 Bankruptcy. Both will impact her credit score.

Chapter 7 Bankruptcy

- Most common bankruptcy claimed
- Eliminates unsecured debts by surrendering or liquidating assets
- A court decides which assets should be sold to pay down your debts
- Chapter 7 bankruptcy stays on your credit report for 10 years

Chapter 13 Bankruptcy

- Second most common bankruptcy claimed
- Borrower enters into a 3-5 year repayment plan to pay down/pay off their debt
- Stays on your credit report for 7 years
- Under the right conditions, borrowers might qualify for FHA, VA, or USDA mortgages while still in Chapter 13 bankruptcy

Kate ultimately chooses Chapter 13. She returns to her mortgage lender and they work out a plan to eventually get Kate into a home of her own.

Here's how Kate makes her homeownership dream come true:

1. After filing Chapter 13, Kate makes an effort to get her job at the tech firm back.

2. She then works remotely while continuing to live rent free with her parents.

3. During this time they are able to find someone to buy her parents' business to further ease their financial strain.

4. By sticking to a tight budget with little-to-no cost of living, Kate is able to pay back her debts in a shorter timeframe and begin saving for her dream house.

Utilization Method Spreadsheet Template

Track your credit cards, regular and retail, and pay towards any that exceed 30% utilization.

Lender	Limit	Balance	Utilization	Age	Closed?	Minimum Payment

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