The Complete Guide to Understanding Credit Ratings & Credit Reports

By David Butler

THE CREDIT REPORTING INDUSTRY

The credit reporting industry is a network made up of creditors, merchants, and other information sources, all supplying credit information on customers who apply for and use credit. This information works its way up the pyramid, reaching its most condensed and accurate format when it gets to the top.

The credit reporting industry exists for only one reason -- managing risk. If the investor does not get their cash back, or if they get it back more slowly than they had planned on, they have a loss - a loss of profit, or a loss of both profit and their original cash. Like you and me, nobody is in business to lose money on purpose. And, like you and me, nobody is in business to work for no pay.

Lenders need to manage risk, and the credit reporting industry provides lenders with the information regarding an individual's character, capability, and credit history, necessary to effectively analyze the risk associated with any particular loan decision.

Invariably, an individual's credit history is a strong indication of that individual's integrity, attitude, and discipline (character); and a measure of the individual's ability to pay his bills (capability). While not infallible, extensive research has supported the reliability of credit reports to accurately predict the risk associated with almost all loan decisions.

Credit Rating Providers

The Big Three - At the top of the pyramid:

Experian (formerly TRW)
Equifax (also known as CBI)
TransUnion

These Big Three are major independent, but interdependent corporations, who act as national clearinghouses for the credit reporting industry. They are independent of each other in terms of the internal operations of their own respective companies; they are interdependent on each other in terms of trying to maintain the most accurate credit history information on file for their subscribers.

Each of the Big Three endeavors to have a national presence, but ultimately, each seems to have particular strength within certain geographic territories. In the southeastern states for example, Equifax has a marked edge over Experian and TransUnion in the accuracy of their credit reports on individuals living in that part of the country. In the northeastern and northern midwestern states, TransUnion is generally considered the primary repository. In the midwestern and western states, it is Experian who is the dominant primary repository.

As with every rule, there are exceptions. All three-credit repositories have a strong presence in California. Many lenders have zip code matrixes, indicating which of the Big Three is the primary repository in which particular zip codes. A lot of these lenders, when ordering only one credit report on a loan applicant, will specify that the report be drawn from the Big Three repository listed as the primary repository for the zip code in which the borrower lives.

If the lender doesn't specify which repository he wants, the agency supplying the credit report will usually draw on the primary repository for the zip code from which the lenders offices are located in.

Usually, what the lender is looking for at the outset is whether or not there is credit information that will automatically kill the loan, so they don't waste a lot of time working on a loan application that never had a chance to begin with. If the single repository credit report looks doable, later on in the loan process the lender will order up either a standard factual credit report, or a trimerge. We'll discuss this further below (see Types of Credit Reports).

Regional Credit Service Providers - at the next level, are the major credit information houses that provide credit information to most lenders. These companies are usually contracted with all of The Big Three Repositories, in order to have access to all three repositories credit information on borrowers. There are about 50 or so of these companies operating throughout the country.

These companies also contribute credit history information to The Big Three repositories. For example, let's say I am a loan officer, and the company I work for has a contract with Chase Information Services, or Standfacts, or DMS, or Credit Data Southwest, or one of the other major credit service providers. I order a credit report from my provider, and it doesn't show a mortgage account that my client says he has.

I contact the provider, who in turn will check all three repositories to see if the mortgage is being reported to any one of them. If it still isn't showing up, my company's contract credit provider has one of their employees contact that particular mortgage lender - to verify both the existence of the loan, and it's mortgage rating (generally the payment history for the past 12 to 36 months, depending on my company's underwriting requirements).

My credit service provider then issues a new credit report to me, now listing the mortgage in question and the months rated. At the same time, they pass the information upstream to the repository they pulled the initial report from, or in many cases, to all Big Three repositories. Shortly thereafter (about 14 days), one, or all of The Big Three will show that account on their data files, and they will have factored it into to the credit rating for future credit reports.
The Local Bureaus - at the ground floor, sit the local credit bureaus. These are the credit reporting agencies that most of us are familiar with to some degree. There is usually at least one bureau in all but the most sparsely populated counties in the U.S. Many of these bureaus are the credit service providers for local merchants, landlords, and businessmen. Many of them are also local collection agencies as well. Part of the reason they provide this service is to get more cooperation out of local merchants toward providing credit account information on their respective customers.

These local bureaus are the guts of the credit reporting industry. It is through them, that credit information is collected from outposts all over the country, and is sent upstream to the Big Three. In many areas, these local bureaus are only working with one repository; hence, as we mentioned earlier, the repository that has the most local bureau accounts within a given area usually becomes the primary repository for that region.

Types of Credit Reports

One of the most confusing aspects of the credit reporting industry is the different type of credit reports that are issued. Adding to that, it seems like every credit report provider uses a different layout style. Some are much harder to read than others are. But basically, they are providing a lot of the same information, one way or another. Once you get used to them, you can pretty much figure out what any different one is actually reporting.

Consumer Reports – a basic consumer report is what an individual gets when he orders up his own credit history. Generally he can order the credit report from his local credit bureau, or if he prefers, he can order the report from one of the Big Three. The costs for these reports range from $8 to $15 dollars, unless you have been recently turned down for credit. In that case, the bureau that issued the credit report that led to your rejection has to provide you with a free copy of your report – if you make a written request within 60 days of being rejected for the credit application in question. The basics of consumer credit reports are your name, SSN, address, and sometimes DOB. Most will generally provide some employment history at the end of the report.

The report will list all the credit accounts that you have under your name, if all those creditors report to a bureau that feeds into The Big Three repository that is supplying the information on the report. These accounts include any joint accounts you have with a spouse, and any accounts where you are a cosigner for someone else's credit account.

The account history will usually include an abbreviation for your account number. Many times the creditor's name is abbreviated too, so sometimes it is difficult to determine who it is that is listing your account. If you can't figure it out, you can be pretty sure that a loan officer can't either, particularly if it is a merchant who is regional, rather than national.
The credit report will generally show when the account opened, what kind of credit account it is (mortgage, installment, revolving) what the credit limit is, what your current balance is, what kind of payment history you have had on the account, the date of last update from the creditor providing information on that account, and how many months it has been rated on the repository's credit file for your history.

When you get a consumer credit report, you will usually get a set of instructions telling your how to read that report. It will explain to you that an R-1 rating means that it is a revolving credit account, and that you have never been late on that account. An R-2 rating means you have had a 30-day late. If you see the number repeating several times on that accounts listing, it means you have had several 30-day lates. An R-3 rating means you have a 60-day late, an R-4 rating means a 90 day late or greater.

In a similar vein, an I-1 rating means you have a clear payment history on an installment account, and an M-1 rating means a clear payment history on a mortgage account. Some reports show the payment history next to the account or right below the name of the creditor, like this – 111112111111113211. Or it might have Cs in place of the 1s. What that indicates is that the account is current the last five months, it had a 30 day late six months ago, and there was a 60 day late 15 months ago, preceded of course, by a 30 day late the month before that. Obviously, you can't be 60 days late until you have a 30-day late!

Keep in mind that it does not matter whether you are 30 days late on making the payment. What the report is saying is that you make monthly payments on that account, and you were late on the payment. If the account is due on the first, and you pay on the 2nd, that is a 30-day late. It affects your credit the same. There are exceptions of course. Most states require institutional mortgage lenders to give you a 15-day grace period. As long as you pay by the 15th, your credit report won't show a late on a mortgage. However, if you pay on the 16th, you have a 30-day late on that account. And likewise, a 60-day late doesn't necessarily mean you are 60 days behind. It means you were or are now late and owing for two payments.

Late pay reporting is strictly the call of your creditor. Sears for example, will usually report you as late if your payment is not in their hands on the due date. A lot of credit card issuers will usually not report a late if they receive the payment within 2 or 3 days of the due date... but most will still bang you for whatever their late penalties are.

Some creditors are poor at reporting late pays, and it can lead to them being booted out of the credit reporting system, because they are sabotaging the system for other creditors who are relying on the credit reports to make informed decisions.

Also, many sub-prime lenders don't report your mortgage history or rating, because they don't want your good payment history on their loan to qualify you for a possible refinance to a lower interest conventional loan.

Most account listings will stay on your history for at least 10 years from the date that you made your last payment on that account. An exception is any derogatory history (explained in Credit Profiling below). Different types of "derogs" have some different periods of time for coming off the report. It is an historical record of your account, so catching up doesn't get a late off of your report. It shows you were late and then caught up... and that's your credit history, right?!

Merchant Reports - many merchants will get the same kind of report that a consumer does, especially if they are just ordering single file reports from local credit bureaus. These are often the kind of reports that small local businesses, and smaller local landlords, will pull on you.

Most creditors and lenders, however, now use the "FICO" type scored reports, which give more detailed breakdowns, and use a "credit score" point total to indicate credit rating (see The Scoring Models below). In addition, they are generally easier to read. Usually, the report will list late payments by date.

Many creditors now use what is termed "FICO Driven" underwriting, using only the score to make a credit approval decision, without regard to the credit profile. The creditors using these types of credit reports pay a little extra for the scoring process. Depending on the merchant and what their underwriting guidelines are, they will order a single report, a dual merge, or a trimerge report... pulling the credit information on a borrower from one, two, or all three repositories.

Standard Factual Reports - for years, this was the credit report typically used by mortgage lenders for real estate loans. This type of credit report is the most expensive and the most detailed. Generally, the standard factual report is prepared by the larger contract credit providers. They first pull a trimerge credit report using all of The Big Three repositories. Then their local employees go to work checking title records, courthouse records, employment records, vital statistics records, and so forth, to make absolutely sure they have as complete and updated credit report as possible. Then they put all of this into a single credit report that is issued to the mortgage lender who ordered it.

With the advent of the FICO scoring systems over the past nine years, the use of the standard factual credit report has declined for many types of mortgages. It is still required for most conventional FNMA/FHLCM loans (especially those requiring PMI), and most FHA/VA loans. However, most sub-prime lenders, and lenders doing 2nd mortgages, now only require a trimerge credit report to underwrite a mortgage loan transaction.

General Comments

Here are some important facts to understand about credit reports:

1) Consumers don't have access to merchant or standard factual credit reports. The different reports can be a problem sometimes if a consumer pulls his credit report, while a lender pulls a scored model, which has a lot more information on it. Many consumers have a difficult time understanding that the creditor probably has a more accurate report.

2) Consumers often wonder why a creditor won't accept a consumer's recent credit report that the consumer just pulled, so the consumer doesn't have to pay the lender another credit report fee. The three primary reasons are: a) that a lender has to protect himself from possible investor lawsuits by pulling the lender's report directly, b) the lenders are usually getting a more accurate credit report,

and c) if they are using the scoring system, they are ordering a report which is already scored so they don't have put the effort or time into the scoring the credit report.

3) Inquiries can lower your credit score. But only if you authorize the inquiry. For example, if you get one of those “pre approved” credit card offers in the mail, the issuer bought a list from a credit provider. The credit provider did not provide them with your credit report; they only put your name on the list that met the issuers' parameters for that particular promotion. If you pull your own credit report, the issuer's request will show as an inquiry, because federal law requires that you have notice of anyone who has received ANY credit information about you. However, this type of inquiry does not count against your credit score, and it will not show up on any credit reports that merchants' or other creditors' pull up on you.

If you take the offer though, and return the application form, you have just given the credit issuer the authorization to pull your credit report. Now the inquiry will show up on your credit history. But it won't automatically lower your credit score. The scoring matrix only reduces the score if you authorize more than two credit inquiries within a 60-day period. The reality is, you could have as many as 13 inquiries on your report during a year's time, and if they were spaced properly, they would not affect your credit score. By the way, inquiries drop off after 12 months time.

4) Paying your bills on time will improve your credit score, paying your bills even one date late will damage your score if reported, and habitual late payments will seriously erode your credit score. Late mortgage payments can quickly destroy your ability to borrow money anywhere.

5) When you cosign for someone else's credit, you are pledging your credit on behalf of that individual. There is a reason for that. The person you are pledging for doesn't meet the credit criteria

to stand alone on the account. If that account develops bad history, it becomes your history. You agreed to make sure that the account stayed in good standing, from the minute you put your name to the credit agreement. For all intents and purposes, that account is your account now, and if it goes bad, your credit will suffer for it.

6) Loan officers and credit managers have nothing to do with an individual's credit report. They only know what your credit report tells them, not how or why it got there. If the report as written disqualifies you for a particular loan, then you need to apply for a different loan program, or fix up your credit report. Usually you will pay a higher interest rate under those circumstances, if you are able to qualify for any loan.

7) If there is inaccurate or incorrect credit information on your credit report that is damaging your credit rating, YOU have to take the appropriate action. Using the telephone is not adequate. You must write a letter to the account in question explaining the problem and asking them to remedy it immediately. At the same time, you should mail a letter to the credit repository (or all of them) that supplied the credit information, disputing the erroneous credit entry. Send the repository a copy of the letter that you sent to the creditor, and any supporting documentation that you have. The creditor may or may not take care of the problem. But, once you notify the repository IN WRITING federal law requires that the repository make an inquiry to the creditor in question, within 30 days. The creditor then has 30 days to provide documentation to the repository, or the disputed information automatically comes off of the report. Either way, you will receive notice within about 10 days from that time as to the status of that account. Usually, things move faster that this, but not always.

If the information stays on your report, one of three things has happened. Either the creditor has documented their claim to the repository's satisfaction, you did not provide adequate documentation that the derogatory information is incorrect, or you did not properly dispute the claim.

There is one other possibility - identity theft. If you are a victim of identity theft, you probably are in for a lot of anguish and a long nightmare trying to clear your credit. But, if you don't do it, nobody else will!

The Scoring Model -- What it is?

Okay, now on to the credit report scoring systems. The scoring model system came into being about nine years ago. It was developed by the Fair, Isaac Company, a computer software designer (hence the acronym "FICO").

The scoring system is licensed out to The Big Three credit repositories, which in turn call it by individual names to help differentiate which repository is issuing which score. Experian calls their score a FICO; Equifax calls their's the Enhanced Beacon; and TransUnion calls their's the Empirica Model.
The score that each repository issues on their individual reports are a reflection of the information that repository has on an individual in their respective credit files. So, the score issued by each repository will usually be different from the other repository's scores. The primary repository will usually have the most accurate score, and if the borrower has had any credit problems over the past few years, the primary repository will usually have the lowest credit score. However, it will sometime work in reverse - if the borrower has recently cleaned up his credit history, the primary repository will usually have the most accurate updates, and in that case, the primary repository may likely show the highest score.

You can look at two different repository's reports on a borrower, and in reviewing the credit profiles; you usually can see what differences in the credit information are likely causing the different scores.

How It Works

Using a complex matrix measuring over 30 different variables in an individual's credit profile, the Fair, Isaacs program converts the profile into a numeric score which is added to an individual's credit report. That score is a reflection of the computer assigned credit risk for that individual. The intent is to reduce the amount of subjectivity credit decision-makers (underwriters) inject into the risk analysis process. The most important variables for mortgage loans are as follows:

Mortgage history
Derogatory Credit History
Liens or Judgments
Length of Credit History
Depth of Credit History
Proportion of Debt to Credit Balances
Amount of Available Credit

Generically speaking, the scores can run from 0 to 1,000. The highest I have ever seen is an 863. However, it is generally accepted that anyone with a 700 credit score is A credit, and over 720 is AA credit. Individual lenders technically assign their own credit grades to the credit scores, but between various lenders they are usually pretty close as to what score constitutes what grade. Here is an approximation of the credit score/grade:

Credit Score Grade:

720 and up AA
700 to 719 A
680 to 699 A-/B+

660 to 679 B+/B
640 to 659 B
620 to 639 B-/C+/C
600 to 619 C/D
580 to 599 D/F
579 and below F

It is important to recognize that these scores are not just about derogatory credit history. They are about determining credit risk associated with a particular borrower, and points are added or taken away based on many different factors related to your credit profile.
For example, once you begin start using credit accounts, you are usually going to have a credit score in the 565 to 580 range. Why so low? Well, you are just starting out, and you have no credit history

to rate. Once you have 12 months of usage on your accounts, you will begin adding points to your credit history. Or if you mess up, you will destroy your credit quickly, and then you really face a tough uphill climb.

You are considered high risk when you start out, because you haven't really proven yourself yet. As you slowly build credit over a year's time, your score will start climbing. But now the paradox sets in. Each time you add a new credit account to your history, your score will drop. Why? Because you have added more debt to your credit load. However, once you have shown the ability to handle the new debt as well, your score will recover, usually in about six months. Once you have a 12- month rating on the new account, you will start having points added to your credit score.

Over time, you build your credit up by scoring points. To score points, you have to use credit, and your creditors have to report your accounts to the credit bureaus. Having a $200 tab at a local restaurant won't help you a bit, no matter how good your payment record is.

You also have to pay your bills on time. Every time you show a late pay, you lose points, and it takes an awful long time to recover them. Once you show 36 months of timely payment history on any account, you are earning the maximum points. Generally speaking, you will have an excellent credit score when you have four major accounts ($1,500 credit limits or higher) all with 36 months spotless payment history, and all usually maintaining balances that are at or below 60% of your available credit limits.

A mortgage rating will boost your score even further. You start collecting points on a mortgage at 12 months, and max out at 36 months. Obviously, this too is where you will lose the most points if you have any late pays on your mortgage history, and where it takes you the longest to recover any lost points.

Where you see scores in the 770 and up range, you will usually see about 8 to 10 years history, with 3 to 4 revolving credit accounts that are rarely maxed out, a sterling mortgage history, and two or more major installment accounts (like car loans/leases) that have been paid off. If the report shows any late pays, it was likely a 30-day, one time, on a revolving account, over three years ago.

How about the man or woman who never misses a payment, always pays on time, and still only has a 640 credit score? Well, he/she uses a lot of credit, it could be that they have too many accounts, and they carry high balances (over 60%) in relation to the credit limits. Or he could be making too many minimum monthly payments, instead of sizable payments. Or yesterday he had a 685 score, but today he has a new $25,000 credit card, with a new $20,000 balance on it. Or he has good credit, but he only has four accounts, no mortgage history, and three of the accounts are less than 24 months old.

The scoring model has weighted adjustments as well. The guy who has a strong credit history and a lot of depth in his credit report, and blip…there pops up a 30 day late. Well, it's been 60 days since, and the late pay wasn't on a mortgage or a car loan, so he's probably going to lose about 3 points on his credit score. If it was a mortgage or a car loan, he will lose about 10 points.

The guy with the 660 score? He's probably going to lose about 10 points on a revolving account late… if it's a mortgage or car loan, he might lose as much as 20 points. At 620, the revolving late will cost him 15 to 20 points and a mortgage or car late could cost him a 30-point reduction in his score.

See, a computer can't tell if you are a deadbeat, or under financial strain, or just nonchalant about paying your bills on time. And it really doesn't matter what the reason is. All the computer knows is that if your score was already low, and you are making late payments, you are a credit risk – by giving you a low score, indicating you are a high credit risk, the credit report tells the next guy to loan you money that he is probably going to regret it!

Reliability of Scoring Models

For a lot of people, it doesn't seem fair. But the truth is, with the advent of the scoring models; more people can borrow more money than ever before. Risk analysis has become more quantifiable, and lenders are more confident now with the predictability factors in their loan portfolio management. Thus, they are comfortable offering more loan programs, and managing the risk by adjusting the interest rates and loan to value ratios according to credit score.

The models aren't perfect, and a lot of mistakes still occur. But there has been extensive research and verification on the reliability of the scoring models, by heavyweights such as FNMA and FHLMC. The research holds up. If you are a 640 FICO, you are a greater risk than a 700 FICO individual. You personally may never have a problem on a new loan, but of all the loans that lender made to 640 FICO borrowers, he knows he is going to have a higher default rate that on the pool of loans he made to 700 FICO borrowers. More than that, he knows approximately what the percentage rate difference of the defaults is going to be between the two groups, and he will adjust his interest rates to make up for the higher losses he is going to absorb for the lower scoring group. He has no way of knowing if it will be you or the other 640 FICO individuals who default... only that it will happen at a higher rate than 700 FICO defaults. And of course, if you are a 600 FICO, the risk more than doubles.

Now here's the fun part. Figuring out where you rate in terms of credit grade. For a car dealer, if you have two decent lines of credit, and you had a couple of payment problems over two years ago, but you have been clean since, even though your score is a 585, he's going to get you a loan. To build you up, he tells you that you have "A" credit, so you are not paying as much attention to the financing being at 14.99% instead of the 8.99% that a real "A" borrower is getting. And not knowing any better, you go out the door thinking you are an "A" credit borrower.

Same thing with some of the consumer loan companies, or electronics stores, carpet stores, furniture stores and so forth that either carry their own financing, or have profit sharing arrangements with consumer finance companies. It is worth keeping in mind that these types of companies can easily repossess the goods, or come after you in court, without a great deal of risk in terms of loss. It's a lot easier to get credit from those kinds of lenders.

Same things with credit card offers. But, these scores can make a big difference in the card offers you receive, what kind of credit limits they will ultimately give you, and what kind of interest rates they are going to charge - both introductory and long term.

If you have a 700 FICO score, everybody wants your business, and you are going to find your mailbox stuffed with credit card offers all the time. You are also going to see a lot of 2.9% and 3.9% promotional rates for as long as 12 month periods, $10,000 to $25,000 credit lines, and long term fixed rates as low as 7.99%

If you are in the 660 to 699 range, you're mailbox is going to be stuffed too... and you'll probably see a lot of six month 2.9% to 3.9% introductory offers as well. But you'll likely see most of your long term rates hovering in the 12.99% to 15.99% range.

Chances are, you'll still see a lot of credit card offers in the 620 to 659 range, but you are going to be getting mostly generic standard high rate credit card offers. Some will offer you 3.9% introductory rates, but most of them will be for about three months or so, and then the card cranks up to 17.99% or higher, on a variable rate basis.

From 600 to 619, you'll still get quite a few offers too, but not too many low introductory offers. You might even get one or two that might offer you up to a $5,000 credit limit, but most will be in the $1,000 to $3,000 range, and you'll be starting right out at the 17.99% and up variable rates.

With a 580 to 599 credit score, you'll be seeing a lot of offers too – but they will be for $500 to $1,000 credit lines, no introductory low rate offers, and most will be starting out in the 19.99% and up variable interest rate range. Many of the offers will be for secured cards – in other words, to get the card, you have to post a savings account deposit with the card issuer, and you will only get a credit limit equal to your deposit. Most of these plans limit you to $500 until you show a 12-month rating on the account.

Credit Profiling

For mortgage lenders, all loan approvals are going to be determined by your credit profile, not just the credit score. Even though the score gives them a bead on your overall risk rating, they are very concerned about certain information contained within your credit report.

What are the factors that mortgage lenders are looking for? Obviously, late payment history rates right at the top. And of course, mortgage history rates is the most important to them. Why? Because mortgage lenders are not real estate investors, they are mortgage investors. They make money on loan payments; they lose money on real estate foreclosures (hard money loans are an exception - more on that later).

Mortgage history is actually viewed by all creditors as critical, because the belief is that a persons' property (especially his home) is his most important asset. If a property owner can't, or won't protect his property by making timely payments, one has to question his credit worthiness for any other type of credit.

Mortgage History

Having a proven track record goes a long way toward qualifying for a new mortgage. In fact, many second mortgage lenders won't make a loan, or they limit the loan amount, for people who haven't had at least a 12-month mortgage rating in the past 12 months. Same thing can happen in cases where the applicant paid his mortgages off several years ago and has no current rating for the past 12 months. First time homebuyers generally have to go through a lot more hoops than someone with current, proven mortgage history does.

Derogatory Credit History

Derogatory credit history can result from several various causes, and it can have different types of results on your credit report:

Mortgage Late - Mortgage payments are the most critical account on your credit history. Less than 12 months history leaves your credit report kind of thin, good history boosts your overall rating, and any lates really hurt your credit rating, even if it's on rental property. So, you can logically conclude that a mortgage lender will be looking at your mortgage rating very closely with regard to mortgages you already have. Mortgage lates stay on your credit report for seven years.

Late Pays - The most common "derog" is related to late payment history. The more late pays you have the worse your report is. Or if you have one or two accounts that show a severe delinquency record, you have some bad credit. Also, the more recent your late pay problems occur, the worse your credit is going to suffer. Late pays on consumer accounts stay on your credit report for five years from the date you catch them up.

Collections - Obviously a serious late pay situation looks ugly on a credit report. When an account goes to collection, it is obviously past 90 days late, and usually indicates you have made no effort to make things right. But sometimes its just because your creditor is a stinker. Nowadays, more lenders will not count a collection against you if it is medically related, but the account will have to be paid off before the loan is closed to get a FNMA loan or paid out of closing proceeds to get a subprime loan. Collections can stay on your credit report as long as the creditor keeps updating the file every seven years, until it is paid. From the time you pay off a collection account, it will stay on your credit report as a "Paid Collection" for seven years.

Charge-offs - When a lender has given up on your default, they may eventually write the debt off for tax or other bookkeeping purposes. But that is ugly on your credit report. Up until about 8 years ago, if you had any charge-offs showing on your credit history, you weren't going to be getting any mortgages. Now, many sub-prime lenders will make the loan, depending on other parts of your credit report, if the charge-off has been over three years old. If it's less than three years old, you are going to have to pay it off to close on a sub-prime loan.

Charge-offs stay on your credit report for seven years from the time the creditor elects to report you as charged off, and 10 years if the credit report is being used for a mortgage application or employment applications. An account can cause you problems for a long time if a creditor sends it out to collection for 12 years before charging it off. The bad history will be on your report for 19 years in that scenario. If you pay off a charged-off account, your credit report will show "Paid Charge-off" for seven years from the time you paid it off. Not pretty on the report, but takes a lot of sting out of the bad credit. In fact, some lenders will upgrade you because they give you a higher character rating if you make good on account that was charged-off.

Repossession - If you show an automobile or mobile home repossession, whether voluntary surrender or not, you are pretty much dead meat for almost any mortgage program for at least five years. There are some exceptions, but less than 3% of repo victims are going to make it through the qualifying gauntlet, until that repo shows over five years old on your credit history. A repossession will show on your credit report for seven years from the date it occurred. However, if the dealer lost money on the resale, or claims you owe more, he can then continue reporting the item as a collection account indefinitely, or until you pay if off. If you pay off a repo account, it will usually show as a "Paid Charge-off" rather than a paid collection, which actually will work a little to your benefit with some lenders. In any event, it will then show for seven years from the date of payoff, or 10 years if you are applying for a mortgage or employment.

Bankruptcy - Believe it or not, you can now get some sub-prime 1st mortgages even if you are still in bankruptcy! How much do they cost...well, how bad do you need the loan? For most borrowers, your bankruptcy has to be at least three years old, and you have to have reestablished credit, in order to qualify for most sub-prime loans. Reestablished credit means showing at least four new major credit accounts ($1,500 or higher credit limits), with one account showing at least 36 months rating, and the other three accounts showing at least 12 months credit rating. You can count a mortgage as one of the accounts if the mortgage was not part of the bankruptcy. You can even qualify for conventional financing if you can prove extremely extenuating circumstances regarding job loss or major medical emergencies caused the bankruptcy, and you qualify otherwise.

For most 2nd mortgages, you are out of bounds until the bankruptcy is seven years old. Bankruptcies drop off seven years from the date of the actual discharge, not the filing date; and will show for 10 years on credit reports for mortgage applications and employment applications.

Forbearance/Modification/Pre foreclosure - these entries on your credit report have a negative impact somewhere between bankruptcy and foreclosure ratings. If you have had clean credit for at least 24 months since the date of the entry, you will generally be okay with most sub-prime mortgage lenders.

You will need to show extenuating circumstances to have any chance for conventional loan programs. These types of entries will generally stay on your credit report for 7 years from the date of final resolution.

Foreclosure - Turn out the lights, the party's over... with rare exception, if you show a foreclosure on your credit report, whether on your own home, a rental, or as a cosigner, your mortgage qualifying days are over, until the foreclosure is off the report. Again, extremely extenuating circumstances might squeak you through on a sub-prime or possibly even a conventional loan, but you better have airtight documentation. Otherwise, you will need to show a deep equity in the property you are borrowing against, you'll be capped out at 65%, and you are looking at a 2 year interest only hard money loan at 10 to 15 points. And that's to refinance. You will find it next to impossible to find purchase money. Foreclosure is on your credit report for 7 years, 10 years for mortgage or employment applications.

Settled Account - If you ever felt pretty smart about getting a creditor to settle for less than full payoff on a delinquent account, you can go ahead and start feeling pretty dang stupid again, the next time you go looking for a mortgage. Fortunately, they come off your report 7 years from the date you settled the account, but you're going to have a pretty tough time until then. Lenders treat this like you are taking advantage of another creditor, and they feel like you will do the same thing to them, so they won't usually bother dealing with you.

Consumer Credit Counseling Services (CCCS) - If you ever want to get a mortgage again in the next 7 years, avoid turning your debts over to CCCSs or any other debt management service. There used to be a time when this program really made sense, and it still ought to - but now most lenders won't touch you until the CCCS is off of your credit report. You're almost better off doing a Chapter 13 bankruptcy, if you want to start getting credit reestablished anytime in the next 7 years.

Judgments/tax liens/general liens - Usually these are at the end of your account histories, and while they don't always necessarily damage your credit rating, they can really impair your ability to borrow money. Why? Because many liens and/or judgments may have priority over a new mortgage - most title companies won't take the chance of insuring the title against that, and most lenders won't take the chance even if the title company will insure title. Just not worth the risk and effort from a lender's standpoint. To get a loan, you are going to have to pay off any liens or judgments showing on your credit report, or prove you have paid them, or otherwise prove that you have been released from liability.

Civil judgments and alimony and child support liens - Are examples of liens that may not affect your credit score too badly, depending on the circumstances. Mechanics liens, tax liens, and creditor judgments or liens will hit your score just like collection accounts. Judgments can ride on your credit report for 10 years, and if the creditor re-files the judgment, he can keep renewing it every 10 years until you pay the bill. Most of these accounts will stay on your report for up to 7 years from the time you obtain a lien release.

Epilogue

Hard to believe but according to the research, the average American has a 700 credit score! But it doesn't matter to lenders as much, because they have figured out how to still make a profit even to higher credit risk borrowers.

So where do you fit in? It all depends on the loan program. Conventional loans offer the lowest rates for residential properties, but you will pay almost 1% more for mortgage insurance (PMI) if you borrow more than 80% of the property value. This is to protect the lender from the risk of a low down payment. Sub-prime loans are available for people whose credit profile won't qualify for conventional loans, or who have special needs with regard to income qualifying, or debt ratio, or similar issues. Sub-prime loans typically run about 2% higher to 8% higher than conventional loans, depending on the credit issues in your file, and the LTV you are looking to borrow. They typically run about 2 to 6 points higher in loan origination fees as well.

Hard money loans are typically available for severely impaired credit situations, or homes where the property needs rehabbing. This is the one area in real estate lending where lenders don't care too much if they get the property back. They usually charge a stiff fee to grant the loan (10 to 15 points), the rates typically run 16% to 18% interest only for 2 to 5 years, and the LTV is generally going to run about 60% to 65%, so these lenders make sure they have a lot of protection from a default situation.

David P. Butler has been a business and financial consultant since 1977. He is also an author and lecturer.