

Reel Loans for Real Life . . .

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Objective

- Know the Types of Common Consumer Loans and How They Differ From Each Other
- Gain Basic Knowledge of How Applications for Consumer Loans are Credit Reviewed
- Understand Credit Scores and Profiles and Things Students Can do to Impact Them Positively
- Take Away Some Tips on How to Help your Students to be Smart Borrowers



Common Types of Consumer Loans

- Car or Other Vehicles
- Mortgages
 - Refinance
 - Home Equity
 - Home Equity Line of Credit
- Other
 - Recreational (boat, snowmobile, RV, etc)
 - Business
- Student Loans – you're already experts on these
 - Federal Consolidation
 - Private Loan Consolidation

Credit



- What is credit to a consumer?

Access . . . purchase of goods and services in lieu of immediate payment.

- What is credit to a lender?

Justifiable risk. . . that you have a willingness and ability to repay loan.

Loan Qualification through Underwriting

Loan underwriting is the process a lender uses to determine whether the risk of lending to a particular borrower under a particular set of circumstances is acceptable.



Underwriting

- Automated Underwriting Functions
 - Credit Score
 - Credit Utilization Ratio
 - Percentage of available credit currently in use
 - Lower utilization ratio is better
 - Credit Portfolio (Bureau)

- Manual
 - Analysis of credit portfolio
 - Income verification
 - Employment History
 - DTI (Debt to Income - including new loan)
 - Loan to Value Ratio (LTV)
 - Collateral Review/Appraisal
 - Down payment

General Loan Approval Factors for all Types of Loans from a Credit Report

- Credit Score – acts like a minimum threshold for approvals generally and/or tiered interest rates.
- Credit History – lenders may look at both the usage and length of credit history as well as derogatory items
 - Trade lines – individual credit accounts (installment loans – this includes student loans, credit cards); balance, account status, date opened, credit limit, delinquencies, etc.
 - Credit inquiries – a list of everyone who has accessed your credit in the last two years, both voluntarily and involuntarily
- Public record items – collection accounts, liens, judgments, bankruptcies and wage garnishments

Credit Report Summary					
Public Records:	1	Past Due Amount:	\$1,607	Inquiries:	5
Installment Balance:	\$1,607	Monthly Payment:	\$0	Inquiries/6 Mo:	1
Mortgage Balance:	\$0	Mortgage Payment:	\$0	Derogatory Accts:	4
Revolving Balance:	N/A	Revolving Available:	N/A	30/60/90:	05/03/13
Credit Score:	580 (300 low - 850 high)				
Credit Score Factors:	1) SERIOUS DELINQUENCY AND PUBLIC RECORD OR COLLECTION FILED 2) NUMBER OF ACCOUNTS DELINQUENT 3) INSUFFICIENT OR LACK OF REVOLVING ACCOUNT INFORMATION 4) DELINQUENCY REPORTED ON ACCOUNT				

Credit Information					
1. Creditor:	VERIZON WIRELESS-GR L	Type:	UNKNOWN - CREDIT EXTENSION, RE		
Opened:	10/07	Last Reported:	03/03	Last Late:	08/04
High Credit:	\$902	Balance:	\$902	30/60/90:	0/0/0
		Mo Pymt:	\$0	Past Due:	\$902
		PROFIT AND LOSS WRITEDOFF			
2. Creditor:	COUNTRYWIDE HOME LOANS	Type:	CONVENTIONAL REAL ESTATE LOAN,		
Opened:	08/00	Last Reported:	04/02	Last Late:	04/02
High Credit:	\$78,000	Balance:	\$0	30/60/90:	0/0/8
		Mo Pymt:	\$0	Past Due:	\$0
		FORECLOSURE COMPLETED			
3. Creditor:	NATIONSCREDIT	Type:	CONVENTIONAL REAL ESTATE LOAN,		
Opened:	08/06	Last Reported:	10/00	Last Late:	09/00
High Credit:	\$57,750	Balance:	\$0	30/60/90:	2/2/5
		Mo Pymt:	\$0	Past Due:	\$0
		03/05-05,08/00-30,05/00-30,04/00-05,02/00-30			

Third Party Collections					
The following records identify collections that have been turned over by the primary creditor to an independent third party collection agency. Collection records may also be found in the Credit Information section of the report if the primary creditor has not sold the debt to a third party.					
1. Agency:	INTERSTATE CREDIT CNTR	Creditor:	COMCAST - SP		
Opened:	11/99	Last Reported:	02/00	Placed:	02/04
Placed Amt:	\$403	Balance:	\$403	Status:	COLLECTION ACCOUNT
2. Agency:	CRED PROTECTIONS ASSOC	Creditor:	COMCAST		
Opened:	05/03	Last Reported:	07/03	Placed:	07/03
Placed Amt:	\$302	Balance:	\$302	Status:	COLLECTION ACCOUNT

Public Records					
The following records identify legal civil action items such as judgments, garnishments, foreclosures, bankruptcies, and federal & state tax liens.					
1. Description:	JUDGMENT	Court:	RAMSEY COUNTY DIST COU		
Docket:	62C123456789	Plaintiff:	SECURITYLINK FROM AMERITECH		
Filed:	06/01	Status Date:	06/01	Assets:	\$0
				Liabilities:	\$1511

RHR's convenient summary section allows you to quickly interpret the entire credit profile. Negative information will generally highlight in red.

Loan Approval Factors

➤ Income

- Verification of stated income
- Minimum income requirements
- Self-employment income



➤ Employment History

- Length of time with current employer (or in a specific field)
- Document current full-time employment

➤ Debt-To-Income (DTI) Ratio Calculation

- $DTI = \text{monthly household liabilities} / \text{monthly household income}$
 - Includes recurring debt – credit cards (minimum monthly payment), mortgage (principle, interest, insurance and taxes), student loans, etc
 - Does not include groceries, gas, utilities, rent
 - Example: \$3,500 monthly bills/\$10,000 gross monthly income = 35% DTI
- Sometimes referred to as “back end ratio”

What's a Good DTI?

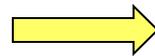
- Generally 36% is an industry standard for a cut-off

Good



DTI < 28%

Okay



DTI between 28-36%

No so good . . .



DTI > 36%

- If your DTI is greater than 36% you can still possibly get a loan but most likely at a higher interest rate
- Students need to understand the implication of borrowing on their future DTI ratio

Loan Approval Factors

- Loan to Value (LTV)
 - Loan amount divided by purchase (appraisal) price
 - Interest rates on home equity loans are often tied to LTV; the lower the LTV the better
- Appraisal – market value of property (may not always equal agreed upon sales price)
- Down Payment
 - Good sign of applicant's ability to save
 - 20% or more of a down payment on a home can avoid mandatory private mortgage insurance
 - Down payment can help with under appraisal
 - Down payment on a car – not always necessary but can help secure a better interest rate and lower monthly payment



Cosigners

- Required for approval when applicants have little to no credit history and/or income
- Even if not required, can often lead to better interest rates or lower fees

Vehicle Loans

- Financing Options
 - Indirect Auto with National and Regional Lenders
 - Dealer Financing
 - Credit Union
- Going in with a Purchase Plan – avoid an emotional purchase
 - Rate
 - Budget
 - Monthly Payment
- Used Car Purchase
 - Blue Book Value
 - Repair Record



Mortgages

- Get a Pre-Approval – especially for a first purchase to avoid an emotional roller coaster
- Prepare for the Down Payment – 5, 10 or 20% of purchase price
 - Some lenders offer no down payment loans
 - < 20% will result in PMI
 - > 20% may help lower payment and allow you to buy “more house”
- Consider Weekly or Bi-Weekly Payment – to speed up pay-off

Home Refinance and Home Equity

- Refinance
 - Better rate
 - Lower monthly payment
 - Cash-out for other goals
- Home Equity Loan
 - Home Improvements
 - Home Repairs
 - College for Children
- Home Equity Line of Credit (HELOC) – similar to home equity loan but interest is only charged as the line of credit is accessed



Other Loans for Real Life

- Recreational Vehicles
- Second Home
- College Loans – for children
- Business Loan

Federal and Private Student Loan Consolidation

- Federal Student Loan Consolidation
 - Can only consolidate Federal student loans
 - Fixed interest rate calculated using the weighted average of all loans being consolidated rounded up to the next 1/8%
 - 10 – 30 year repayment
 - Standard, Graduated, Extended, Income Based, Income Contingent and Pay As You Earn options
 - Public Service Loan Forgiveness
 - No credit approval needed
- Private Student Loan Consolidation (Refinance)
 - Credit approval required
 - Choice of fixed or variable interest rates
 - Extend repayment
 - Option for multiple loans – both private student loans (including Bar Study) and federal loans.



Federal and Private Student Loan Consolidation

- Advantages

- Convenience – one monthly payment
- Simplification – one interest rate rather than many



- Possible lower rate, better benefits
- Lower monthly payment as a result of a longer repayment term can help DTI calculation

- Disadvantages

- Longer repayment term means higher total cost
- Loss of borrower benefits from original loan
- Possible loss of subsidy or forgiveness

A Recipe for Loan Approval Success

- Solid Credit History – no instances of adverse credit/collections in the last seven years
- Above Average Credit Score: >725
- Verifiable income and low DTI
 - W-2 or 1040's if self employed
 - DTI < 30%
- Cosigner if possible – two credit-worthy borrowers are better than one

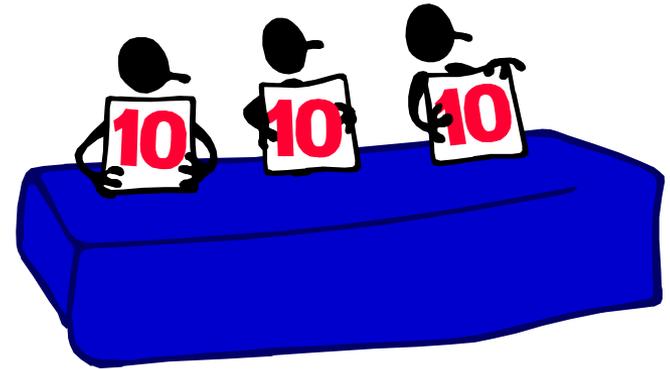


Students' Focus for the Future Should Be . . .

- Credit Score
- Debt to Income (DTI) Ratio

Encourage Students to Know their Credit History and Credit Score

- Prepare – Review When Thinking of Taking a Loan
- www.annualcreditreport.com provides a free copy of an individual's credit report from each of the three credit agencies
- If a consumer is denied credit, he/she is entitled to a copy of their credit report and should request it to see if everything is accurate or what needs improvement.
 - Read the fine print – many consumer sites (such as credit monitoring companies) offer a credit score. This is not necessarily a FICO score.
 - Some companies create scoring models with different factors/percentages. The score you are given may not be the FICO score the lenders are seeing.



Building Good Credit

1. **Start slowly** – don't apply for too many cards at one time.
2. Even **paying interest only** on a private education loan helps establish credit
3. Every time credit is checked for lending purposes it's an **inquiry on the credit** report and can impact your score.
4. Individually they have little to no effect on a credit score, but many inquiries (especially in a short period) can **bring a score down** by several points.
5. Use only the credit that **you can afford** to pay back.
6. Pay balances **in full and on time**.
7. If a balance is carried, **keep it small**.
8. Lenders look at the **percentage of credit balances against the credit limits** – credit utilization ratio. The higher the percentage the greater the risk.
9. Use credit. Cards that are **opened and stagnant** can affect negatively over time and should be closed (when paid in full).
10. Don't close accounts when they **carry balances**. Pay the balance off first, then close, if desired.

Repairing Damaged Credit

- Repairing credit takes **time**. Like a diet, it seems like it took no time to gain the extra weight but patience and hard work is needed to lose it.
- Develop a **budget** – do a realistic assessment of how much money you take in and how much money you spend.
- If you are having trouble making ends meet, contact your creditors to create a payment plan or see a legitimate **credit counselor**.
- Bankruptcy is generally considered the debt management option of **last resort** because the results are long-lasting and far-reaching.
- **Errors** – Contact both the credit bureau and the organization reporting the erroneous information. Each are responsible for correcting inaccurate or incomplete information under the Fair Credit Reporting Act.



Credit Score

- Credit scoring is an efficient, objective and consistent method for lenders to measure the “risk” of an applicant
 - Scores based solely on information in consumer credit reports (Experian, TransUnion and Equifax)
 - Score can be different for each agency since information at each agency can be different
- FICO – Fair Isaac and Company (Most well-known but there are others; Beacon, PLUS, Vantage)
 - Score derived using a mathematical equation that evaluates payment history, amount owed/credit utilization, length of credit history, pursuit of new credit (inquiries), types of credit used
- Credit Score – ranges between 300 and 850
 - Higher score = lower risk
 - Lower score = higher risk

Credit Score	Credit Description
730 – 850	Excellent
700 – 729	Great
670 – 699	Good
585 – 669	Average
300 – 584	Bad

Credit Scores – Score (Reason) Codes



- Up to four “score codes” are provided when a FICO score is pulled. These codes are the top reasons why the score was not higher. Codes may be able to help a lender explain to a borrower why credit was denied.
- Additionally, these codes may be more useful for the applicant than the FICO score itself. Codes may illustrate potential errors in a credit report as well as providing tips on how to improve one’s credit health.

FICO – Top Reason Codes

- Serious **delinquency**
- Serious **delinquency**, and public record or collection filed
- Derogatory public record or collection filed
- Time since **delinquency** is too recent or unknown
- Length of time accounts have been established
- Level of **delinquency** on accounts
- Number of accounts with **delinquency**
- Amount owed on accounts
- Proportion of balances to credit limits on revolving accounts is too high
- Too many accounts with balances

Remember Your Budget Context

- Living Expenses
 - Housing
 - Food
 - Utilities
 - Insurance
 - Clothing
 - Miscellaneous

- Savings
 - Emergency
 - Retirement
 - College for Children
 - Other



Guess Who's Looking at Credit History and Scores?

- Potential Employers
- Potential Landlords
- Utility Companies
 - Cell, Cable, Electric, etc
- Insurance Companies
- Potential Spouses – Market Place radio report on 1/23/2014
 - 75% of women and 57% of men considered a person's credit score when dating.
 - CreditScoreDating.com

In sickness and in wealth



StockPhoto
Online dating: A keyboard with a love key.

Smart Consumer Habits for Borrowing

- Understand DTI as you borrow student loans
- Research product before purchase – such as a car model, make and year
- Understand the interest rate indices and historical behavior
 - Wall Street Journal (WSJ) Prime
 - T-Bills (Treasury bills)
 - LIBOR (London Inter Bank Offered Rate)
- Understand what a good rate is for the market and your credit
- Challenge the timing of wants versus needs
 - Can it wait?
 - Is this want worth financing over time?
 - Can you save for it?

Questions and Resources

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- <http://www.citizensbank.com/student-loans/establishing-good-credit.aspx>
- www.annualcreditreport.com
- www.bankrate.com



Articles:

- <http://www.npr.org/2014/01/08/260752428/on-time-payments-heal-all-credit-report-wounds>
- <http://www.marketplace.org/topics/your-money/ask-carmen/sickness-and-wealth>