**Home Loan Mortgage Options
For Bad Credit Borrowers**

presented by [Attorney Mory Brenner](http://www.debtworkout.com/)

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| **Never again obtaining a home mortgage loan consistently surfaces as the primary fear of people considering bankruptcy. Luckily, those searching for a home mortgage loan will find that within one day after their bankruptcy discharge home loan financing will indeed be available to them. Within the mortgage business lending to borrowers with very, very bad credit including bankruptcy and foreclosure can go by several names including the sub-prime market, b,c,d credit lending or simply bad credit home loans. The wonderful side of this industry for debtors is the fact that it exists. On the other hand individuals with bad credit must understand that what will be expected from them and that what will be available for them in the sub-prime mortgage market bares little resemblance to the type of home mortgage loan available to a borrower with perfect credit.** Self Pre-Qualification Credit Score        Before attempting to [obtain a home mortgage loan](https://secure.financialfirebird.com/loans/matrix/mmimtx.php?campaign_id=79&subcampaign_id=dwolm&esource_id=519650), borrowers should first understand exactly where they stand from a credit point of view. Lenders categorize borrowers using two systems. The first mirrors standard grades used in school. Borrowers' credit will be evaluated and given a grade, where A is the best, B will be credit showing a bit of tarnish, C represents fairly bad credit, D means very bad credit, occasionally I've even seen some F's. I have included a chart estimating where someone's credit will fit into this system. Remember that humans evaluate most of these credit reports, with the result that some credit evaluators will assign different grades to the same borrowers and that some lenders may assign more or less importance to certain types of negative items on a credit report.         The next type of scoring model more closely resembles an SAT score, with 800 being near perfect and 400 approaching as bad as it gets. These scores carry names such as FICO, Beacon or Empirica; each of these names corresponds to one of the particular major credit reporting agencies. The exact mathematical formulas used to calculate these scores remain proprietary information of the credit bureaus, computers use the formulas to establish a [credit score](http://www.reportscreditscore.com). It is safe to say, however, that the same negative items which would affect a letter grading system also negatively affects the numeric scoring systems. You may use the Equifax link on the [mortgage tools](http://www.mortgagepages.com/mortgage_tools.html) page to get a copy of your credit report online including your FICO score. For more information I have written an article on [credit repair and credit rebuilding](http://www.debtworkout.com/credit_repair.html) or you may enroll in our [free guide for improving your credit score](http://www.repairbadcreditreport.com). Loan-to-Value Ratio        The next important concept in calculating loan eligibility would be the ratio between the amount being borrowed and value of the property being placed as collateral. The common name of this ratio is "loan-to-value" or LTV. Easy examples include: A borrower qualifying for an 80% LTV loan buying a $100,000 house could obtain a loan for $80,000; refinancing a $200,000 house at 70% LTV would mean a $140,000 mortgage. Borrowers should note that the value used for this calculation on new purchases would almost always have to be the lower of the purchase price or the appraised value. With a refinance, provided that the home owner has been in the property for a long enough period of time (usually six months to a year) appraised value only may be used in the loan to value calculation. This distinction can be a problem in certain cases such as when a borrower has brought a home truly worth $100,000 at auction for $60,000.00. The home may actually appraise for $100,000 but the purchase price of only $60,000.00 must be used resulting in a greatly diminished availability of funds for the purchase. Money needed exceeding the mortgage usually comes from a cash down payment. When the loan available due to the LTV limitations for the borrower yields too little to buy the home in question owner financing, family help or a [down payment grant](http://www.mortgagepages.com/pic/) can sometimes bridge the gap. In many D credit cases the lender requires at least 5% must be put down even though the sale may not necessitate it. In budgeting a transaction do not forget to include closing fees. When LTV issues prevent a refinance some [debt workout options](http://www.debtworkout.com) may help. Provided the borrower qualifies for the loan based on their credit score and loan to value requirements the next hurdle will be a review of the debt to income ratio. Debt-to-Income Ratio        Calculate the debt to income ratio by adding together all of the borrower's debt payments, including not only the loan being applied for but also any auto loans, consumer debt, credit cards etc, etc; divide this number by the net cash available each month available to the borrower for living expenses as well as debt. Most lenders would prefer this ratio to be approximately 40% or less; in fact, to obtain certain low interest loans a low DTI would be a requirement. In the sub-prime market lenders will also allow more flexibility to the debt to income ratio allowing the percentage to climb as high as 55 to 60%. As with the other parameters, flexibility abounds in sub-prime lending. On the other hand, the borrower pays for these flexibilities in the form of a higher interest rate. Affordability        With all of the above data gathered you should be able to determine approximately where you fall in the credit rating system used by most mortgage lenders. While points and rates can vary greatly the broad chart attached below indicates what you might expect to find for rates, points and loan to values. You may use a [basic mortgage calculator](http://www.mortgage-auto-loan-calculator.com) to figure projected mortgage loan payments or a [home afforability calculator](http://www.mortgage-auto-loan-calculator.com/home_afford.php) to estimate how much house you can pay for. Cautions for potential mortgage borrowers Pricing for Good Credit Borrowers         Lenders charge more points and higher interest rates to those with bad credit. Loans to borrowers with poor credit carry far more risk and lenders deserve compensation for this risk. Borrowers with good credit should not let themselves enter into a loan agreement where they pay points and rates based on a bad credit loan. One national company recently filed bankruptcy to protect themselves from litigation on fraudulent loan practices.         One of the common fraudulent loan practices involved charging good credit borrowers bad credit rates and points. If you have worked hard for good credit you deserve the benefits. It may take some extra work depending on your geographic area but don't allow yourself to pay more interest and fees than you have to. Pricing for Bad Credit Borrowers        While bad credit most often means higher interest rates and origination fees for anyone needing a loan, there are limits to amounts generally deemed proper in the mortgage industry. A point on a loan means a fee corresponding to one percent of the amount of the loan. As indicated in the charts, people with great credit may sometimes pay no points while those with poor credit may pay up to four points or five points. Unwary customers may find loan brokers attempting to charge them as much as ten points. Occasionally charging this many points is justified. For example a loan of only $15,000.00 for ten points still presents a relatively small fee in terms of the total dollars charged. I have seen other "hard money" loans where private financiers take risks well beyond even the standard sub-prime market where perhaps the extra fees make sense. In general, however, higher points should be a red flag that someone is trying to take advantage of you. It is not uncommon for such transactions to be explained by a claim that the mortgage broker can provide a loan where no one else can. Most cases do not merit these claims. Finding a loan broker or lender to do a difficult loan may take some extra work on the part of the borrower, but with enough diligent effort sources can be found that will not only make the loan but will treat the borrower fairly. What many borrowers fail to notice regarding points could cost them many thousands of dollars. Points may bear many names like "origination fees", "discount fees", "broker fees" or "yield spread premium". Regardless of what they are called there are two basic forms of points. The first type I will refer to here as "Upfront Points". The borrower pays these points to either the broker or the lender as compensation for creating the loan transaction. In general points represent a loan brokers only source of income. They work hard to make a loan come together and deserve to be paid.         On the other hand some unscrupulous brokers may charge points far in excess of the industry standards to a customer who does not realize what to expect. The chart below should provide a general guide for consumer expectations. In addition to these points borrowers may have the option of paying additional points to "buy down" the rate. As long as the borrower understands the mathematics there is nothing wrong with buying down a rate using points. Just remember that the numbers dictate that most often a minimum of 3 to 5 years will be needed to break even on buying down a rate. Unless you have a fairly high level of confidence that you will be remaining in the house and you will not be refinancing for a very, very long time buying down the rate may not make sense. For the majority of people homes and mortgages are often sold or refinanced over periods of time 5 years and less making buying down a rate imprudent.         The second type of point I'll refer to as a "Back End Points". The lender generally pays these points to the mortgage broker. In some cases these fees simply represent additional incentive from the lender to the broker to make a particular loan. In other cases it represents a payment from the lender to the broker as a reward for obtaining a loan with a higher interest rate. For example a borrower may potentially be able to obtain a loan at a 10% interest rate yet the broker will only offer an 11% interest rate in order to receive two extra back end points from the lender. In cases where a lender is merely trying to promote a certain product and offering brokers a small reward through back end points, for example one point or less, there may be no harm to the consumer. I have seen cases where back end points may be useful, particularly in an effort to save a house from foreclosure and where available funds are so limited that closing fees make the difference between keeping a house or losing a house. By charging no up front points and allowing the broker to be paid through back end points it is possible for the broker to make his fair compensation on a loan and for the borrower to complete a transaction with thousands of dollars less out of pocket at time of closing. The borrower in such cases should make sure they are aware of exactly what is transpiring and attempt as soon as feasible to refinance into a lower interest loan.         Problems with back end points predominately take two forms. First, as with front end points, unscrupulous brokers may attempt to charge far in excess of market practices. These problems are compounded by the second issue: some states do not require disclosure of back end points, leaving the consumer no way to even realize what is happening to them unless they have a very, very clear understanding of market interest rates which allow them to discover a discrepancy resulting from back end points. Where mandated reporting exists or has been undertaken by a responsible loan broker look for back end points on the HUD1 closing statement form near the top of page 2. Since the broker got paid directly by the lender the figures will not be in the columns with the numbers. Look for it as a part of a description on the left. It may be called a "yield spread premium" or simply list the fee as an amount paid from the lender to the broker paid outside closing (POC). Borrower Courtesy        A problem I see just as often as lender abuse involves Borrowers demanding unrealistic points and interest rates from brokers and lenders. Bad credit loans take a great deal more work than good credit loans and the risks taken by the lenders are significantly higher. Borrowers with bad credit should not expect to pay the rates and points charged to someone with good credit.         Excessive rate shopping, for example sending a mortgage application to 15 or 20 loan brokers, will often result in the brokers not paying attention and rightfully being annoyed by such attempts. Contacting many sources in order to eliminate those who do not have the ability to make your loan is one thing. Pitting more than a handful of legitimate brokers against each other generally will not yield any significant difference in what you may achieve. Remember most mortgage brokers are working on a commission basis and if they feel you are wasting their time they will tend to ignore you and more on to the next customer. Particularly in the [bad credit loan](http://www.mortgageloan.com/bad-credit-mortgage) market where each loan can be quite time and labor intensive. Mortgage Timing        While the D credit market provides a vehicle to offer financing to almost everyone it does not follow that everyone should take advantage of it. Just because you may be able to get a mortgage does not mean that committing to a mortgage and purchasing a house would be a prudent financial decision. Postponing a house purchase may allow the potential borrower time to change some of the important variables. Most obviously the accumulation of down payment money. Not only does a larger down payment result in smaller payments and better affordability (because of the reduced loan balance) but a larger down payment also results in a lower loan to value ratio translating to a smaller interest rate and again lower payments. In addition to using time to accumulate the down payment the time passing in and of itself will help to heal any damaged credit. Even better, aggressively use the time to rebuild your damaged credit. The best answer for when to buy a house with bad credit will be different for every individual. Those who buy sooner always have the option of refinancing to obtain a lower rate a year or two later. Personal cash flow issues may necessitate no option available other than waiting. Be careful when examining cash flow not to leave yourself without some cushion, especially if the cash management issues caused your earlier credit problems. Taking on mortgage payments beyond your means may lead to yet another down-fall and in the credit industry a second collapse will be looked upon much more harshly. Many creditors are forgiving if a basically creditworthy person had an isolated problem. Those with more than one bout of bad credit may be looked at as a habitual problem borrower or even someone who fraudulently seeks credit without intent to repay the debt.  |

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| Credit Grade |  FICO Score | Credit Items |      LTV |       DTI | Interest Rate |      Points |   Max LTV |
|          A |     620-800 | none or minor |       80% |        40-45% |     -1.75 / .5 |       0 / 2 |       125% |
|          B |     550-650 | 1 or 2 30-60 day lates |       80% |        45-50% |      -1 / 2 |       1 / 2.5 |       100% |
|          C |     500-620 | many lates 1 up to 120 days |       80% |        50-55% |        0 / 3 |    1.5 / 3 |         95% |
|          D |     400-580 | many lates over 120 days, bankruptcy, foreclosure etc. |       65% |        55-60% |     2.5 / 6 |    2.5 / 5 |         n/a |

Notes to Chart:
1. **All items represent rough estimates. Only a lender can quote or offer you a specific mortgage.**
2. FICO is a trademark of Equifax
3. A, B or C borrowers needing higher DTI can opt for a lower credit score product.
4. The LTV column shows the standard LTV for a regular purchase or refiance. Electing a lower LTV can sometimes mean a lower interest rate. The Max LTV column shows maximum LTVs available for special high LTV loan products, such loans carry **much** higher interest rates.
5. Rates in the chart relate to the [prime rate](http://www.nfsn.com/library/prime.htm). While most residential rates generally relate to other indexes, I use it here only because more people have familiarity with prime rate. For example -1.5 / 2 in the chart would mean a range of prime minus 1 to prime plus 2. With prime at 9.5% this would mean an esimated range of 8.5% to 11.5%.