4-2: Be Able to Borrow

Cast List

- Darryl
- Terri
- Maya, Terri's younger sister
- Stan Porter, Mortgage Broker

Synopsis

- Maya is planning ahead for her first home and wants to know if she'll qualify for a loan

Location

- Studio
- Stan's Office

A. How Banks Decide
   a. Suppose you've decided it's a good idea to borrow. How will the creditor decide whether to lend you money?
   b. 4C's
      i. Capacity = Can you pay back the loan?
         1. Need enough income to pay bills/other debts first
         2. Bank looks at:
            a. How long been in job (at least a year)
            b. Debt-to-income ratio ($/month vs. expenses/month)
      ii. Capital = Can you afford to borrow (and how much)
         1. Net worth (Value of assets [car, home, investments] vs. how much you owe [debt])
            a. Positive net worth = you can manage your money
         2. They determine how much $ you can afford to borrow
      iii. Character = History of your behavior with money
         1. Assess your bill-paying history
         2. Any bankruptcies? Judgments, etc.
         3. Bank may ask for explanations
         4. Alternative forms of history (proof of payments for rent, utilities, regular deposits to savings account, etc.)
      iv. Collateral = Guarantee bank will get money back
         1. Can be car, house, etc.
         2. Unsecured loan = no collateral; this is a credit card
         3. If no credit history, can get someone to cosign
      v. Fair Credit Reporting Act (if denied based on something in credit report, can dispute)
   c. What creditors will ask for

B. Obtain and Review Your Credit Reports
   a. Creditors will look at your credit reports
   b. Credit reports are a record of your current debt and how you have handled debt and payment
   c. Credit reporting agencies (Equifax, Experian, TransUnion)
   d. It's a good idea to look yourself and make sure they are accurate
      i. Due to Fair Credit Reporting Act, allowed to get copy (free) once every 12 months
      ii. Only authorized sources:
         1. annualcreditreport.com (beware of soundalikes!; can get there from FTC.gov/credit to be 100% sure)
         2. 877-322-8228
         3. fill out/mail form on annualcreditreport.com or FTC.gov/credit
      iii. Other circumstances in which one can get free credit reports (FCRA)
         1. If denied for credit, insurance, or employment based on credit report (bad credit history, not at current address/job long enough, income doesn't meet creditor's criteria):
            a. Have right to get an explanation: will get denial notice/adverse action notice with reasons
            b. Have right to dispute inaccuracy with agency and company providing incorrect info
         2. If unemployed and looking for job w/in 60 days, public assistance, inaccurate due to fraud/identity theft
      iv. Otherwise, must go to each credit reporting agency and pay up to $10 (info on FDIC.gov/moneysmart)
   e. Agencies don't make decisions, just present information

	f. Your responsibility to make sure they are correct
	g. How to read statement
	  i. Potentially negative items
	  ii. Accounts in good standing
	  iii. Revolving and installment accounts
	  iv. Requests for credit history
	  v. Personal information
	h. What to do if there's an error
	C. Do You Know Your Credit Score?
	a. Credit score is report summarized in a number
	  i. FICO most common; score is from 300-900
	  ii. Vantage; generated from three agencies; 501-990 and A-F letter grades
	b. What goes into a credit score
	c. How to access your numbers
	D. Build Stronger Credit
	a. Pay off loan w/highest interest rate first
	b. Talk to creditor (reduce payments, change terms, etc.)
	c. Credit counseling (let creditors know you're doing this)
	  i. Help develop personalized spending, advise on managing money, debts
	  ii. Free educational materials/workshops
	  iii. Counselors are certified and trained in consumer credit, money and debt management, spending
	  iv. Credit repair can take several years; be wary of companies that promise to fix everything right away
	E. If You're Denied
	a. The adverse action notice
	b. Disputing inaccuracies
	c. Equal Credit Opportunity
	d. How credit counseling works

Theme music up

DARRYL: Welcome to another episode of the “Money Smart Podcast Network, with Darryl and Terri.”

TERRI: *(laughing)* He means the “Money Smart Podcast Network, with Terri and Darryl.

TERRI: Today we have a special guest: my little sister Maya!

DARRYL: A *very* special guest, if I say so myself.

TERRI: Maya, can you share a little with the audience?

MAYA: Sure– *(muffled)*… is this thing on?

TERRI: *(laughs)* – It's on… let's just get it back on your lapel… there you are. Technical issues resolved!

MAYA: Okay. So, um…when I finished college, I had a small college loan, which was good… but my first job had an equally tiny salary. Not good. Money was a struggle, so I moved into a small rental apartment with three roommates.

TERRI: What happened from there?

MAYA: Well, as you can imagine, my goal was to get my own place as quickly as possible! Over the first few years, I got a couple of promotions and a few bonuses, and I was able to pay off my loan.

DARRYL: *(a little over the top)* That's absolutely terrific, Maya!!!! Way to go—

TERRI: *(cutting him off on purpose)* —Go on.

MAYA: And I tried to start saving for my own home. But… I'm still in that dinky apartment… down to one great roommate, thankfully. But I'm more than ready to get my own place.

DARRYL: You should check in my neighborhood – there are some great starter homes – and *(clearly talking about himself)* I know a fantastic painter! He even brings his own pizza—

TERRI: —Whoa! First things first, Darryl! Maya, we've lined up a meeting with our friend and mortgage broker Stan Porter. Stan's worked with many lenders and borrowers over the past 12 years, so he understands what it takes to qualify for a loan. *(to Darryl)* Darryl, Maya may *feel* like she's ready to buy her first home, but Stan's going to help her learn for sure if she's *actually* ready to borrow. We'll catch up with our audience at Stan's office.

SFX: sounds of Maya and Terri leaving the studio

DARRYL: *(to Maya, as she goes out the door)* Maya, there's some room in my car! *(he runs off after her; maybe we hear him boomerang back, as he still has his headphones on)*

SFX: Cross fade Darryl's bumbling with Stan's office; we may hear typical office noises coming in from other rooms: typing, phones, etc.

TERRI: And, we're back.

DARRYL: This time from the Fifth Street office of mortgage broker extraordinaire, Stan Porter. Nice location, Stan!

STAN: *(laughs)* It's memorable – once I tell clients they can find me right between Mighty Muffin and Chocolatier Heaven, most of them at least come in for a first appointment.

TERRI: Thanks for helping us, Stan. Like many in our audience, my sister Maya is eager to get her own home. Can you walk her through what banks are looking for in a borrower?

STAN: Maya, I tell my clients to focus on what I call the 4 Cs – plus their credit reports.

DARRYL: Sounds like 5 Cs!

STAN: Either way! The first C is "Capacity" – lenders want to know whether or not you'll have the *capacity* to pay back the loan. So they look at your income in relation to your monthly mortgage payment and other loans and expenses, to ensure you can meet all your obligations.

TERRI: That's where debt-to-income ratios come in, right?

STAN: Right. That's the total debt payments you make each month, as a percentage of your gross income. Lenders look at anticipated housing payments – including loan principal, interest, insurance, property taxes, and any homeowner association fees.

TERRI: Don't they also look at other debts, like credit cards?

STAN: You jumped ahead of me! Yes – they look at the overall debt-to-income ratio – including all your long-term credit or loan payments, like car payments, credit card bills, or education loans.

MAYA: That's good news. I have only two car payments left, and I pay off my credit cards almost every month.

DARRYL: *(over the top)* That's fantastic, Maya!

STAN: *(not listening to Darryl)* That's excellent Maya. Lenders also look at work history – they like to see you've been in the same job for at least a year. And if you are relying on another source of income to repay the debt, they want to make sure that's steady as well

MAYA: I've been with my current employer nearly 3 years.

STAN: So far, you're in great shape.

DARRYL: So, she's good for a loan and ready to house shop?

STAN: Not yet – we have quite a bit of information to cover.

TERRI: Darryl, why don't you run to Mighty Muffin and grab us some coffee?

DARRYL: I know when I'm not wanted. Terri, I know you like your coffee black. Maya?

MAYA: Mmmm. A *big* latte, with 2 sugars and extra cinnamon.

DARRYL: Ah – all sugar and spice. I should have known. *(SFX: He starts to leave.)* I'll be right back, Maya.

TERRI: Darryl! What about Stan?!

DARRYL: What about – oh! I mean, of course! What kind of coffee—

STAN: —thanks, Darryl, I'll pass. So, Maya, the next C is "Capital." Lenders want positive net worth – meaning they want to see that your assets are more than what you owe. It's a measure of how well you manage your money.

TERRI: Stan, what can borrowers include as assets?

STAN: Cash, including balances for checking, savings, and certificates of deposit, as well as investments, including retirement accounts. If you're already a homeowner, the equity in your home is an asset. Your car, and any other personal property with significant worth, such as a boat or recreational vehicle – and any high-value collectibles, such as jewelry and coins are also considered assets.

MAYA: Okay – so my savings and my car are probably about it for assets. After I add up those, what do I deduct? That must include what I still owe for my car and credit cards – but what about rent and other living expenses?

STAN: Great question, Maya! No, standard living expenses wouldn't count – just outstanding debts or loan balances.

MAYA: Oh, ok.

STAN: On to the next C or "Character." Lenders will look at your bill paying history. If you've had a bankruptcy, collection agency action, or had your wages garnished, those would be negative factors. Even if you're current on your bills, but have maxed out your credit cards, lenders will view it as a red flag.

TERRI: So many people have special circumstances that cause financial problems. Do lenders take that into account?

STAN: Yes – banks may ask for an explanation on any negative history. If you have a good explanation, you can document steps you took to work with creditors, and if you can demonstrate an overall history of responsibility when it comes to handling money, those are factors banks may consider.

MAYA: Don't they look at positive things too?

STAN: Absolutely! In addition to being on time with loan payments, if you pay utilities and rent or mortgage on time, those are pluses. And if you've made regular deposits into a savings account, they take that as a good indicator of financial responsibility.

SFX: Darryl rushes back in; we hear noises as he takes items out of their crinkly paper bags and puts them on the table.

DARRYL: Here's your coffee Maya – and some – sweets for the sweet!

TERRI: You're quite the character, Darryl.

DARRYL: And here's your coffee, Terri – extra strong – and bitter.

TERRI: Hey!

DARRYL: Just kidding, I got you a triple chocolate mini-bundt with all SEMI-sweet chocolate.

TERRI: You just never stop.

MAYA: I think I have a good payment history – so what's the next "C"?

STAN: That's "Collateral" – something of value that assures the lender it'll get its money back, even if you can't make your payments.

MAYA: What does that mean?

STAN: As with most home loans, the home itself will be collateral. For loans like a car loan or a boat loan, it might be the car or the boat itself. Of course, there are unsecured loans—

MAYA: —unsecured loans?

STAN: Those are loans where collateral isn't required, like credit card debt and some personal loans such as student loans.

DARRYL: So is this where the amount you have for a down payment comes in?

STAN: Right! A larger down payment reduces a lender's risk – making it easier for them to give you a loan, and possibly a better interest rate, if your credit is good.

TERRI: What if you have the right income and down payment, but don't have much credit history? Can that make it hard to borrow?

STAN: It can. That's why I encourage new borrowers who can afford it to maintain at least one credit card account they pay in full every month.

MAYA: What does that do?

STAN: It builds a credit history.

DARRYL: Is it possible to get a loan without a credit history?

STAN: It's possible, particularly if you can get another person to co-sign the loan.

DARRYL: So if Maya could get a good friend to co-sign, say, someone who lives in her neighborhood—

TERRI: —when someone co-signs, they're actually accepting responsibility for the loan, right?

STAN: That's correct – that's why everyone involved needs to discuss and understand the arrangement.

DARRYL: So what kind of paperwork will Maya need to cover the 4 Cs with lenders?

STAN: Great question! To verify your income, Maya, you can show pay stubs and W2s, along with contact information for your employer. For information on your checking and savings accounts, you'd provide current bank statements and statements for any other assets, such as investments. Current account information, contact information, and balances for all outstanding debts are required, and records of rent payment and your landlord's contact information are also important. When you get ready to fill out a loan application, you'll be given a complete list of required documents.

TERRI: What about the bill payment history we talked about?

STAN: That would all come from Maya's credit report.

DARRYL: I'm always hearing about people who get turned down for a loan because of a bad credit report. Some people even think that the credit reporting agency is making that decision.

TERRI: I think it was YOU who thought that!

STAN: No, the agencies only report on information they collect. It's the creditor or lender who makes the actual decision about whether or not to lend money to someone.

MAYA: So why is your credit report such a big deal?

STAN: The creditor or lender makes the decision, but it is very likely that they will make their decision based on the information in your credit report. It helps them determine how likely it is that you will repay the debt….. If something on the credit report is incorrect—

DARRYL: —poor Maya might be penalized for something that isn't her fault!

MAYA: So – wait. Who are the credit reporting agencies?

STAN: Well, there are three major credit reporting agencies – Equifax, Experian, and TransUnion. But there are others as well. Every time you apply for credit or a loan, the lender may report it to one or more of these credit agencies. Once you obtain the loan, they may also report your history of paying each month—in other words, whether you paid on time. The credit reporting agencies maintain a list of the open credit and loan accounts you have, and a history of accounts that have closed. Inquiries from lenders or any negative information from public records will also be shown in the credit report – things like tax liens or court-ordered judgments.

DARRYL: Why three different agencies – don't they all have the same information?

STAN: The kinds of information they collect are very similar. But not all companies report to all of them, and each agency uses a different format for its reports. You may find that your lender reports information on your loan to one credit bureau rather than all three. So it's important to check the reports from all three.

MAYA: And you can check your own report?

STAN: Oh, yes! And I encourage everyone to check theirs! If you happen to find anything wrong, Maya, you can work to correct it as soon as possible.

TERRI: How often should people check their credit reports?

STAN: At least once a year. Everyone is entitled to a free report every 12 months from each of the three agencies.

STAN: You can visit www.annualcreditreport.com to request each of these three free reports. Or you can call toll-free to 877-322-8228, or complete a request form at the website of the FTC, or Federal Trade Commission. The specific site is www.FTC.gov/credit.

DARRYL: *(with authority)* Maya, just beware of other sites or services that claim to provide "free" reports but actually require you to buy services or products.

TERRI: You found that out the hard way, huh Darryl?

DARRYL: Yes I did….

STAN: You should also know that some other situations also qualify you for free reports. If you're denied a loan, employment, or insurance because of something in your report, you're entitled to a free report if you request it within 60 days of getting the notice.

TERRI: That's the Fair Credit Reporting Act, right?

STAN: Exactly!

TERRI: It gives you the right to dispute errors in your credit report whenever you may find them, including if you learn about them through a loan denial.

DARRYL: So, what should Maya – or, uh, anyone – do if there are errors?

TERRI: We'll cover the process in another episode.

STAN: You're also entitled to a free report if you're unemployed and you plan to look for a job within 60 days. You also can get a free report if you're on public assistance, or if your report is inaccurate because of fraud, including identity theft.

MAYA: What does it cost if you just want to check more often?

STAN: A consumer reporting agency may charge you up to eleven dollars for another copy of your report within a 12-month period… and some of the unofficial reporting places charge even more—

DARRYL: When I accidentally went to a site other than www.annualcreditreport.com, I accidentally signed up for a service that would allow me to check it any time I wanted to…for more than fifteen dollars a month!

TERRI: I'm guessing you keep accidentally paying for the service because you accidentally forgot to cancel it.

DARRYL: That's correct.

TERRI: Can you walk us through a typical report, to help Maya when she gets hers?

STAN: Sure. Here's an example – notice the report identification number – you'll need that if you find errors and need to contact the reporting agency, which you can do by phone, mail, or online.

MAYA: Ok.

STAN: The credit history section includes a list of "Potentially Negative Items" – you want to pay special attention here, because these can really affect your credit score. This section will include any past due accounts, history of bankruptcy, liens, and the like.

TERRI: And I see there's a space under each account for "Your Statement."

STAN: Yes – where you can address an error or note special circumstances. For example, let's say an account shows as past due for the month of February. But the "Your Statement" section has an entry that explains, "Paid in full by check no. 55145 on Feb. 10. Copy of check furnished to credit card company on March 5."

MAYA: So there's a place to explain yourself.

TERRI: Right!

STAN: There's also another section called "Personal Statement." This statement remains in your record for two years, and displays to anyone who is authorized to see your report.

DARRYL: Can you give an example of how that might be used?

STAN: A client used it to document that he actually requested to close an account – not that the creditor closed it, as shown on his report.

DARRYL: The next section lists accounts in good standing – can you just skip these since there are no problems?

STAN: No – you should look at these carefully, too! Make sure these are accounts you actually opened and use. Closed accounts that appear open can make it seem that you have too much credit. You want to correct any accounts that aren't actually yours. That could be a simple reporting mistake – or evidence of identity theft.

DARRYL: The report is showing revolving for some accounts and installment for others… what's the difference?

STAN: An installment loan has an established repayment period for a specific amount – like a sixty month car loan for fifteen-thousand dollars. A revolving account, like a credit card or line of credit, is more open ended. As you pay down the amount owed, your available credit "revolves" or resets to the original limit.

MAYA: What else should I check on my reports?

STAN: It's good to look over the section on requests for credit history. A request can come in from a new employer, or when you apply for a new loan or credit account. You should also check that all your personal information is current and correct.

TERRI: If someone is denied credit, what can they do?

STAN: If your request is denied, you get an "adverse action" notice that lists the reasons for denying your application. If the notice doesn't give any reasons, you have the right to ask for and receive them.

MAYA: What if the denial is because of something that's wrong on a credit report? You said you have the right to dispute something wrong.

STAN: Yes – you can file a dispute with both the reporting agency and with the creditor who provided the erroneous information. There's great information online from FTC.gov/credit, but I'll mention a few quick pointers. One key thing is to keep careful records of all your communication with the reporting agency and the creditor.

TERRI: Really?

STAN: You can often file a dispute online or maybe even over the phone, but I always advise people to write, because it's easier to track and keep copies. The Federal Trade Commission (FTC) site has a sample letter you can modify to tell the credit reporting company what information you think is inaccurate.

DARRYL: Are there specific things you should include in the letter?

STAN: Yes. The letter should identify each item on your report that is wrong, state the facts and reference your documents, and request that the erroneous information be corrected or removed. With the letter, attach copies – never originals – of any proof you have of the error, such as a receipt, bank statement, or cancelled check. I suggest people send the same type of information in a backup letter to the creditor, as well.

TERRI: But what if you don't hear anything back?

STAN: Your best bet is to send the letter by certified mail, "return receipt requested," so they have proof that the credit reporting agency received it. Make sure you keep copies of your letter and original documentation.

DARRYL: How long should you allow for a response?

STAN: By law, the credit reporting agency must investigate potential errors, usually within 30 days. They contact the creditor, which must investigate and report back. If the creditor finds information is inaccurate, it must notify all three credit reporting agencies to correct the information in your file. Afterwards, the credit reporting company must give you the results in writing and a free copy of your report if the dispute results in a change. This doesn't count as your free annual credit report.

DARRYL: What if the creditor won't admit a mistake?

STAN: You can ask that a statement of the dispute be included in your file and in future reports. And you can ask the credit reporting agency to provide that statement to anyone who recently received a copy of your report. However, expect to pay a fee for this service. You can also file a complaint with the Consumer Financial Protection Bureau. Go to www.consumerfinance.gov/Complaint.

DARRYL: We've been talking about credit reports – credit reports are different than a credit score, right?

STAN: Right. Creditors sometimes use credit scores, which are based on your report, to assess your risk, or they might generate their own score, or use one calculated by another firm. Two that are often used are the FICO or Fair Isaac score, and the Vantage score.

TERRI: How do these scores get assigned?

STAN: A FICO is calculated using a computer model that compares your information with credit reports of thousands of consumers – they range from 300 to 900 – the higher your score, the better.

MAYA: I've never heard of a Vantage score.

STAN: It's a uniform system the credit reporting agencies use. Vantage scores range from 501-990, with letter grades; a score of 901 or higher is an "A" while 501-600 is an "F". Because the agencies often have some different data, there can be variance in your scores.

DARRYL: What kinds of things affect your score? Does my history of …uh… erratic saving habits hurt me?

STAN: The scores reflect what lenders view as credit risk. Your payment history and how timely and consistent you've been making payments are factors. How long you've had credit is another. Your total debt and debt-to-income ratios affect your score. Even having too much available credit can affect your score. Lenders are concerned that you could get into serious trouble quickly with access to a large amount of credit.

MAYA: Wait – I opened two credit card accounts in the last year so I could build my credit score – and now I might get penalized for having too much credit available?!

STAN: Relax! Lenders want to know you're experienced with handling credit, that you don't overuse it, and that you don't have an available credit line that could bury you in debt. It's about balance… You have a great history with your car and student loans, so if you only have two credit cards, and don't have high balances, banks won't consider you a big risk. However, they do look at the length of your credit history – so the longer you have those accounts in good standing, the better for your credit score.

DARRYL: Some of us aren't as in good shape financially. How can we build a better credit history?

STAN: Start by paying all your bills on time, every month. Next, work to get revolving credit balances paid down, and then paid off.

TERRI: Any tips to help people do that?

STAN: It can be smart to pay down the account with the highest interest rate first. Put as much as you can toward that, while paying the minimum amounts due for other credit accounts. You'll save on interest. When that account is paid off, put that amount toward paying off the next credit balance.

TERRI: Do you recommend trying to get a better payment plan with creditors?

STAN: It can't hurt to ask, Terri. Explain your situation and see if the lender might adjust the loan terms.

DARRYL: What about working with a credit counselor – we've suggested that for some callers.

STAN: Working with a reputable professional credit counselor is a great idea. A counselor can help with spending plans and debt management, and provide advice for credit issues. People do need to understand that building a good credit history takes time – often years. There's no such thing as quick credit repair.

DARRYL: What if you're denied credit – do you have any recourse?

STAN: As I mentioned, you'll get an adverse action notice that should explain why your request was denied. If not, contact the lender and ask for that information. If it is due to an error on your credit report, you can follow the steps we talked about to dispute the error and get it removed from your credit report.

MAYA: One of my friends said I could have trouble getting a loan because I'm single – that sounds wrong.

STAN: Actually, that's not just wrong, that would be illegal. The Equal Credit Opportunity law makes it illegal to discriminate on the basis of race, color, religion, national origin, sex, marital status, or age in making lending decision.

DARRYL: Do you have any tips on finding a credit counselor – for our audience?

STAN: A good credit counseling agency will usually offer a variety of services, including free financial education and seminars.

DARRYL: How does the counseling usually work?

STAN: Usually the counselor will schedule an initial interview by phone or in person to go over the individual's financial status, talk about debt and budgeting, and get a good sense of their individual needs. Depending on the situation, they might offer counseling and education, or they might contact creditors to help try and negotiate payment plans.

TERRI: Are there any warning flags in working with a counselor?

STAN: Well, as you've covered on another podcast, a legitimate counselor does not make loans. I warn people to be very cautious about debt consolidation. Some of those loans and programs are scams. Do a lot of research, and talk with financial advisors you can trust.

MAYA: So, it sounds like my next step is to request my free credit reports.

STAN: Yes!

TERRI: Thanks so much for helping us today!

DARRYL: Thank you –

Theme music up

DARRYL: – and thank *you*, Maya, for joining us! You know, any time you want to look at houses in my development—

TERRI: —Goodbye Darryl. This has been the "Money Smart Podcast Network, with Terri and Darryl."

Music fades