get ready

MGIC

KEYS TO SUCCESSFUL HOMEOWNERSHIP

Understanding Credit

Once you've made the decision to buy a home, it's time to review your credit standing. If you don't, you can be sure your lender will when you apply for a mortgage. It's a good idea to know what you're working with before you fill out your mortgage application. That way you have some time to establish, improve or repair your credit standing. Exactly where you stand will help determine whether you are approved for a mortgage and, if so, the interest rate you will be charged.

Get Ready to learn how to…

Understand, establish and maintain — or regain — good credit

In today's world, it's just about impossible to live without credit. It's a powerful tool, but as with all tools, credit can be extremely dangerous in the hands of those who do not understand its power and how to use it.

Credit permits you to obtain something now for little or no money out of your pocket and pay for it over a specific period of time. Today, almost everyone uses credit in one form or another. Mortgages, credit cards, personal loans and car loans are all types of credit.

LEARN MORE ABOUT YOUR CREDIT

get ready

to learn how to… understand, establish and maintain — or regain — good credit

There are two types of credit…

Open-end credit is extended on an ongoing basis, but usually with a limit on how much you may borrow. It is often referred to as revolving credit. As you repay the balance due, a specified credit limit is then available to you to use in the future. Credit cards, such as VISA and MasterCard, are the most common form of open-end credit.

Closed-end credit is extended on a one-time, limited basis, such as a car loan or a mortgage. Although you may still have a positive relationship with the lender after paying off the obligation, you still must requalify each and every time you want another loan.

Where does credit come from?

Credit is most frequently extended by department stores, finance companies, oil companies, credit unions, commercial banks and credit card companies. Those who extend credit are called creditors.

In order for credit to be extended to you, a creditor looks at two things:

You as a risk. Each creditor has different ways of evaluating applications for credit. By reviewing factors such as income, length of employment, how long you've lived at one residence, previous credit history, amount of outstanding debts, stability of your checking and savings accounts, number of dependents, and so on, creditors can determine, to a certain degree, whether you will repay the amount borrowed over a certain period of time.

What you are purchasing as collateral. Items such as furniture and appliances are easy for a creditor to repossess if you fail to make the credit payments. Therefore, since a creditor has less to lose in the long run, credit may be extended to even those with a questionable ability to pay when it comes to purchases like stereo systems and refrigerators.

When a home has been posted as collateral for a loan, the foreclosure process can be costly and time-consuming. The lender assumes a greater amount of risk at a lower interest rate. Therefore, the lender is going to evaluate you and your credit history more carefully when you're trying to buy a house.

How do you establish a good credit history?

Establishing a good credit history is actually pretty simple:

Open a checking and savings account. Maintain your checking account by keeping enough money in it to cover all outstanding checks. Make regular deposits in your savings account to establish a history of savings.

Apply for credit gradually — once your checking and savings accounts are in good working order and if you believe your budget can handle the financial load — through retail store credit cards, a major bank credit card or a gasoline credit card.

Don't apply for more credit than you can manage. A credit card establishes you with credit as soon as your application has been approved.

Make regular payments for the products or services you purchase with credit. Every time you make a payment as agreed to a creditor, you are building a favorable credit history. If you consistently repay your debts, your positive credit history will build.

When to use credit

Use credit sparingly and effectively. First, determine how much credit you can comfortably afford — 15% to 20% of your take-home pay is a good rule of thumb. Develop a household budget — a detailed list of your income and expenses. If you find that you cannot afford credit purchases, considering your current income and expenses, you should

get ready

still concentrate on establishing good credit, but continue making most of your purchases using cash.

Credit purchases should generally be limited to those that can be paid off at the end of the month. Larger purchases should be evaluated based on need, a usable life and a payment schedule established to assure that the debt is paid off quickly.

Here are a few more guidelines for using credit:

When you are building equity. A mortgage is a good example of using debt to build equity. Most people could not afford to buy a home by paying cash. Yet a home is often the largest and most important investment many people will make, and the profits they realize after the house has appreciated may likely far exceed the amount of interest they paid to purchase it.

When the interest is tax deductible. Borrowing may make sense in this case. Mortgages and home equity loans remain two of the last types of tax-deductible consumer loans.

To take advantage of sales. But ask yourself the following questions before you purchase a sale item with a credit card: Do you really need it? Will the amount of interest you pay on the amount you charge plus the sale price still be significantly less than if you paid full price for the item with cash?

When you are financing a business or venture. Few people who start businesses have the financial means to begin without borrowing. In many cases, they find the convenience of using credit cards preferable to begging their banker for loans.

To shop by mail. Sending cash or a check to an out-of-town company you've never dealt with before can be dangerous. If you pay by credit card, you are protected under the Fair Credit Billing Act if your order turns out to be different than what you specified.

Continued…

Avoid paths to credit troubles

Failure to repay the credit extended as agreed, paying only the minimum payment due and assuming they have great credit is where most people get in trouble.

Late payments affect your credit history. It doesn't matter that the credit card balance is only $5, or that the payment is only one day late, or that you pay the late fee. Failure to pay on time will put a black mark on your credit history, one that will last for a year or more.

Minimum payments are another trouble spot. While making the minimum payment is acceptable, it does very little to reduce your outstanding debt.

Don't assume you have a great credit history just because of the continuous offers for revolving credit you receive in the mail. Make sure that you have credit when you need it for a mortgage or a personal loan. You don't want to be denied due to poor history or overextension of credit cards.

get ready

Getting help…

If you do experience unexpected financial difficulty or need to clean up your credit, don't be afraid to ask for help:

If you fall behind on payments, the worst thing you can do is to wait until you are so far behind that your creditors resort to collection agencies. By contacting your creditors right away, you may be able to make lower payments temporarily, until you get back on your feet. Be sure to get all agreements in writing. You can also contact a professional financial counselor or a credit- and budget-counseling agency if you need help developing a budget/debt reduction plan.

If you are unable to make your monthly mortgage payment, the best thing you can do is to contact your lender immediately. Doing so just may help you avoid foreclosure. Many lenders will work with borrowers who have a good payment history to arrange a temporarily reduced payment plan. Some lenders may reduce or suspend your payments for a short time. Others may agree to change the terms of the mortgage by extending the repayment period to reduce the monthly debt. But the only way they can help you is if you tell them you need help.

If your credit standing is less than stellar, there is good news. It may take some time, but it can be fixed. If you work to reduce your debt by making regular, on-time payments for at least a year, your credit history will be much better looking to future creditors. You can also contact a professional financial counselor or a credit- and budget-counseling agency, if you need help developing a budget/debt reduction plan:

Consumer Credit Counseling Service

1-800-388-CCCS (2227)

National Foundation for Consumer Credit

8611 2nd Ave., Suite 100
Silver Spring, MD 20910
Phone: (301) 589-5600

Neighborhood Housing Services

Please check your telephone directory for a local Neighborhood Housing Services office or a Neighborhood Reinvestment Corporation district office.

Another good resource on credit is www.myfico.com. You can also get help from a credit service, where you can review, protect and learn what steps you need to improve your credit.

Although establishing or regaining good credit may take time, once you start making on-time payments, your credit history begins to improve.

get ready KEYS TO SUCCESSFUL HOMEOWNERSHIP

This publication is proudly sponsored by MGIC, the nation's leading provider of mortgage insurance. Since its inception, MGIC has helped millions of American families achieve the dream of homeownership. We remain committed to helping potential home buyers to better understand the mortgage process and to overcome the single greatest hurdle in homeownership, the down payment. When you are ready to buy a home, be sure to ask your lender how you can reduce the required down payment by financing with mortgage insurance from MGIC.

71-42838 (10/08)