

SECTION 4: UNDERSTANDING HOW TO PREPARE FOR BORROWING AGAIN

Preparing to borrow again involves many of the same activities you had to do in order to secure the financing to purchase your home. Before you meet with a lender, get your finances in order by reviewing your **credit score**, preparing a realistic spending plan and gathering your financial records.

Checking Your Credit Score

Poor credit is one of the top reasons reputable lenders turn down prospective **borrowers**. Many lenders have loans available for those with credit problems, but those loans will have higher interest rates than the loans offered to borrowers with good credit. Just as when you applied for your mortgage to purchase your home, lenders place great importance on your credit score when deciding whether to approve your loan application, as well as how much credit to extend and at what interest rate.

Credit scores are often called “FICO® scores” because most credit scores are produced from software developed by the Fair Isaac Corporation (FICO). With FICO scores, higher scores are better scores, and most consumers score between 300 and 850. FICO scores are provided by the three major **credit reporting agencies**, although they have different names and ranges at each of the three agencies:

CREDIT REPORTING AGENCY	FICO® SCORE	RANGE
Equifax	BEACON	300–850
Experian	Experian/Fair Isaac Risk Model	340–820
TransUnion	EMPIRICA	150–934

Generally, lenders consider any score over 700 to be a good credit risk and will offer such borrowers the best rates available according to market conditions. Borrowers with low scores are frequently served by loans at higher rates. If you have a low credit score and want to qualify for a better interest rate, keep in mind there is no quick fix to improving your credit score. Improving a credit score takes time. Meet with your housing counselor or a reputable nonprofit credit counselor to learn how to raise your score. For more information on credit scoring, visit www.myfico.com.

It is a good idea to order and review your own **credit reports** and credit scores before you apply for a loan. That way you can correct inaccuracies, remove old information and improve your credit record before you meet with a lender. If you have not ordered any credit reports within the last 12 months, you will be able to get free copies from all three credit reporting agencies. Request your report from www.annualcreditreport.com, by calling (877) 322-8228, or by completing the Annual Credit Report Request Form (www.ftc.gov/bcp/online/edcams/credit/docs/fact_act_request_form.pdf) and mailing it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. The free credit

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reports do not include credit scores, but you can purchase those when you request your free annual credit reports through the Web site or by contacting one of the nationwide credit reporting agencies:

- Experian: www.experian.com or (888) 397-3742
- Equifax: www.equifax.com or (800) 685-1111
- TransUnion: www.transunion.com or (800) 916-8800

Preparing a Realistic Spending Plan

You probably made a household spending plan when you were saving to buy your home, and you may have already updated it to include all the expenses of homeownership. Refinancing and borrowing against your home equity costs money, and you will want to make sure you have some savings to pay for those up-front costs. If you have a current spending and savings plan, review it prior to applying for another loan. If not, you will need to prepare one that includes all of your monthly obligations, regular expenses and money set aside for savings. A realistic spending plan is particularly important if you are borrowing more money or your new monthly mortgage payments will be higher. That way you will be able to determine if any increases in your monthly mortgage obligations will be acceptable to your lender as well as affordable to you, given your current lifestyle. There is often a difference between the payment you qualify for with the lender and the payment amount that is comfortable to you. Lenders will look at your total **debt-to-income ratio** — how much of your monthly income goes toward paying your current mortgage, credit card bills, car payment, student loan, child support and other obligations listed on your credit report, as well as the payments on any additional equity debt for which you are applying. Most conventional lenders like to see that ratio under 40 percent of your income. Keep in mind, however, that your debts are not your only expenses. You may have to pay for childcare, school tuition or medical expenses that are not reported on your credit report and usually not taken into account by your lender when determining how much you qualify to borrow. You need to be realistic about what your actual monthly expenses are so you can determine for yourself the loan amount you can afford.

If you need to prepare a spending plan, it is easy to do so. All you need to do is gather information about your income and expenses and then write down how much money you make and how you spend it and think about how you might save and spend your money more wisely. Preparing a spending plan essentially involves three steps:

- *Determine your net monthly household income*, or how much money you bring in each month after taxes and other payroll deductions have been taken out. To determine your **net income**, collect any papers that show how much money you bring in from your regular job, occasional work and any other sources like alimony, child support or disability payments. Add up all the money you receive each month.
- *Calculate your monthly expenses*, or the things you spend money on, such as your house payment, utilities, car payments, credit cards, insurance, food, clothing, childcare, gasoline, movies, sporting

events, church and charity donations, etc. To calculate your expenses, gather any materials that show bills you pay every month and add up the total amount of money you spend each month.

- Calculate your **discretionary income**, or the money that is left over at the end of the month to spend or save. To calculate your discretionary income, subtract your regular expenses from your income.

Once you see where all of your money is going, you can make changes to your spending habits to reduce your expenses and increase your discretionary income. You can use one of the many budgeting worksheets available online or in financial planning guides to draw up your desired spending plan.

Gathering Your Financial Records

Before meeting with a lender, call and ask what records you need to supply for your loan application. In addition to the same financial documents about your income, debts and savings you needed when you applied for the loan to buy your home, you will need to assemble information about your home and existing mortgage. The following is a list of information typically required by lenders when you are refinancing or borrowing against the equity in your home:

- Income tax returns and other income information;
- Bank statements;
- Payoff of existing mortgage;
- Copy of recorded deed to your home;
- **Homeowners insurance** policy;
- Most recent property tax bill; and
- Copy and description of home improvement plans if you are borrowing against your home equity to make renovations.

The checklist on the next page can help you gather your financial records prior to meeting with a lender.

Loan Documentation Checklist

General Documents

- Drivers license or other picture ID

Documents to Support Income

- Income tax returns for the last two years, including W-2s and all attached schedules
- Most recent two months' pay stubs from all sources of employment
- The name, address, phone number and fax number of every employer you have had in the last two years
- Child support payments
- Pension benefits
- Seasonal employment income
- Government assistance/SSI benefits
- Social Security benefits
- Statements of stock dividends

Documents to Support Savings and Recent Bank Activity

- Savings account statement(s) for the last three months
- Most recent checking account statement(s)
- Most recent brokerage statements showing investment balances and recent transactions

Documents Related to Existing Mortgage

- Payoff statement of existing mortgage(s)
- Copy of the recorded deed
- Most recent homeowners insurance policy
- Most recent property tax bill

Other

- Veteran's certificate of eligibility
- Certified copies of divorce decree and separation agreement
- Copy and description of home improvement plans if renovations are being made
- Letter(s) of explanation for any gaps in income or negative credit items
- Student loan repayment information