

# CREDIT: How it affects your future

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- How Lenders Underwrite Loans & Why a Credit Score is Important

# Credit

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- What's in a Credit Report
- What Affects Your Credit Score
- Underwriting Loans

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# WHAT'S IN A CREDIT REPORT?

# What's in a credit report?

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- Identifying Information
  - Name, Social Security number, date of birth, address
- Creditors and Payment History
  - Positive and Negative
- Bankruptcies, Judgments, Liens, Lawsuits
- Inquiries You Initiated
  - Loan and credit applications (excluding credit card solicitations)
- Employment Information

# Creditors and payment history

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- Basic account information
- Current balances
- Credit limits
- Highest balance
- Late payments – 30, 60, & 90 day increments
- Total length of time accounts have been active

# Inquiries section

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- List of every company that has checked your credit reports in the previous 2 years
- Does NOT includes credit checks you make yourself, employment checks or unauthorized checks
- Rate shopping for home, car, etc...only counts as 1 inquiry.
- Be careful when authorizing credit checks

# Why Should I Develop a Positive Credit History?

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- Financial Institutions
  - Difference in interest rates, terms and amounts approved
- Employers
- Landlords
- Insurance Companies
- Utilities
  - Cell phones, electric, etc.



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# **WHAT AFFECTS YOUR CREDIT SCORE?**



# Credit score section

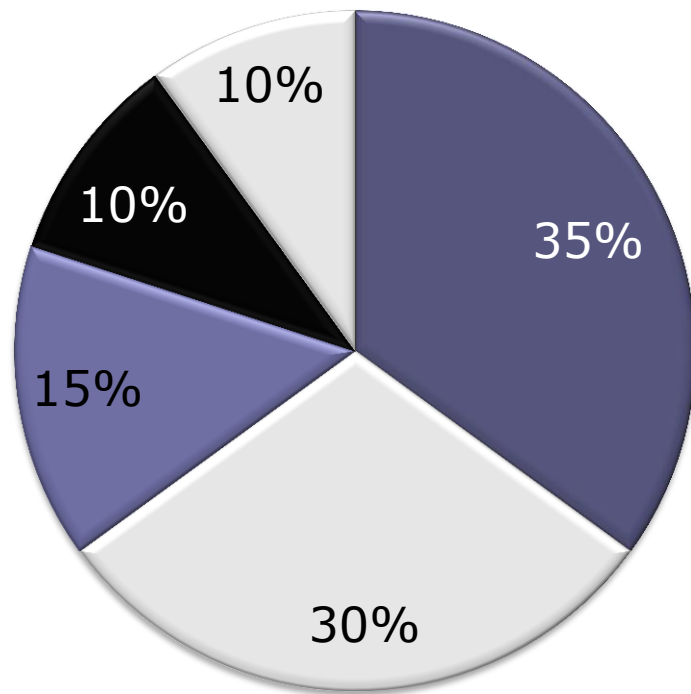
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- Scores range from 300 – 850
- Current average credit score is 693
- Scores adjust monthly
- 3 national credit bureaus each give you a score that will vary from each other

# Credit Basics

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## □ What affects your credit score?



- Payment History - 35%
- Amounts Owed - 30%
- Length of Credit History - 15%
- New Credit - 10%
- Types of Credit Used - 10%

Source: myfico.com

# Reviewing your Credit Report

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- Check your credit report at
  - [annualcreditreport.com](http://annualcreditreport.com)
- You can pull one report from each credit bureau annually
  - Trans Union
  - Experian
  - Equifax

# Establishing Positive Credit

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- Make payments on time
  - Utilities, cell phones
  - Avoid collections, judgments and bankruptcy
- Stay under credit limits
  - Try to pay credit cards in full each month
- Be selective about which cards you hold
  - Have one or two major credit cards instead of multiple department store cards

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# UNDERWRITING LOANS

# Consumer Loans

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## ***Disclaimer:***

*The following is basic information about common underwriting practices.*

*The information provided here does not reflect any lender's specific underwriting guidelines or standards.*

# Full Picture

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- Borrower and Cosigner
  - Credit Score
  - Credit History
  - Types of Tradelines
  - Ability to Repay
  - Student Loan Balances
  - Negative Items
  - History with the Financial Institution



# Risk-Based Pricing

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- Lenders price based on credit risk
- Excellent to good scores will get lower rates than average to low scores.
- A person with a 750 score will get a better rate than someone with a 600.
- Lenders are required to disclose score information to consumers after a loan application.



# Credit history

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## □ Length

- Short history = riskier loan
- A longer credit history provides a more complete picture of what types of loans a consumer has had and how those loans were repaid.
- A really short history in the case of a borrower may benefit from having a cosigner with an established history.

# Types of tradelines

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- Secured
  - Any type of mortgage, auto loan, or anything secured by something of value, such as a CD.
- Unsecured
  - Credit card, line of credit, personal loan, private student loans
- Student Loans
- Authorized-User Accounts

# Ability to repay

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## □ Income Requirements

- Must show the ability to repay current debts plus the new loan that's being requested
- Lenders will usually have minimum income requirements for the borrower and the cosigner

# Ability to repay

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## □ Debt to Income

- $\text{Monthly Obligations} / \text{Monthly Income} = \text{DTI}$
- DTI limits can vary based on the type of loan. Mortgages, for example, usually have very stringent guidelines for DTI.



# Ability to repay

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## Ability to Repay

- Debt to Income Example
- J. Brown makes \$48,000/year (\$4,000/mo)
  - Mortgage \$1,200/mo
  - Auto Loan \$ 150/mo
  - Credit Cards (3) \$ 250/mo
  - \$1,600/mo
- $\$1,600/\$4,000 = 40\%$  DTI
- Assumes a certain percentage for cost of living items and discretionary spending.

# Unsecured debt vs. secured debt

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- Lenders may have limits on the total balance of unsecured debt compared to income.
  - For example, if S. White makes \$30,000/year but has \$15,000 in credit card debt, that could be viewed negatively, even if the DTI calculation is acceptable.
  - Higher amounts of unsecured debt is considered risky. If a person does not repay an unsecured loan, lenders have nothing of value to recover.

# Credit limit vs. balance

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- What is the person's credit limit compared to their balance?
- Credit Card #1
  - Limit = \$5,000
  - Balance = \$4,000
  - This could be viewed negatively and your score could be affected
- Good rule to follow
  - Keep your balance under 30-50% of the limit

# Student loan balances

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- Private Loans
  - Aggregate limits
  - With that financial institution or overall
- Federal Loans
- Borrower vs. Cosigner
  - Cosigner may be cosigning for multiple students



# Negative tradelines

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- Late Payments
- Collections
- Force-Closed Accounts
- Bankruptcy

# Relationship with financial institution

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## □ History can help

- If there are any credit challenges, having a positive history with the financial can help.
- Underwriting guidelines are *guidelines*, not rules.
- Exceptions can often be made when a person is close to cutoffs for a score or DTI, provided the reasoning is sound.

# Thank you!

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