

June 2010 Newsletter Article

## **Credit Behaviors That Lenders Look For**

**Did you know that insurers use your credit behavior as a basis for predicting the chance you'll submit an insurance claim?**

**Here are some helpful tips below we found useful to help overcome high rates and especially the dreaded word DENIED.**

### **Why did I get reported to only one credit bureau?**

You have three unique credit reports maintained by the three independent credit bureaus - TransUnion, Equifax and Experian. Because these bureaus obtain credit data independently, it is fairly common to receive an alert that relates to only one of your credit reports. In some cases, a change will only be reported to one credit agency and this is the case if a creditor only reports to one agency or if an inquiry is made to only one credit agency when you apply for new credit or loans.

### **Why does each bureau obtain different information about the same account?**

You have three unique credit reports maintained by the three independent credit bureaus - TransUnion, Equifax and Experian. Because these bureaus obtain credit data independently, it is fairly common to receive slightly different information from each bureau regarding the same account.

### **How long do inquiries stay on my credit files?**

Your inquiries will stay on your credit bureau for two years. Remember not every credit agency reports same information to all 3 credit bureaus.

### **What is a debt-to-income ratio?**

Your debt-to-income ratio compares the difference between your monthly income and the monthly amount you spend to maintain your debt. Lenders will often look at this ratio to determine how much additional debt you can handle.

**Debt Analysis** compares the difference between the monthly income and the monthly amount you spend to maintain your debt (as listed in your credit report). This is called a debt to income ratio. Lower debts to income ratios are better because lenders view borrowers with low debt to income ratios as having a better capacity to repay their debts.

### **Lenders typically view debt to income ratios less than 20% as Very Good.**

A low debt to income ratio along with a good credit standing, which is determined by timely repayment of debt, are both considered very favorable by lenders. Most often, a low debt ratio along with a good credit standing will entitle you to receive the best interest rates and in some cases provide less collateral.

Having a low debt ratio is an indication that you have the ability to handle more debt, if needed. This may be an ideal time to consider making major purchases such as a new home, car, or to make those investments or home improvements you have been considering.

It is important to keep in mind that individual or household capacity for debt can vary significantly. Your lifestyle or stage in life can dramatically influence your ability to carry debt. Based on your current debt ratio, you are probably able to save part of your income each month. If your discretionary spending makes it difficult for you to save each month, you might consider reducing your discretionary spending in order to increase your monthly savings. This may make it easier to repay any additional debt if needed.

**Lenders generally view debt to income ratios between 40% - 55% as Fair.**

At the lower end of this debt to income range, you should be able to manage your debt satisfactorily. However, taking on any additional debt could cause you to become over extended and you may be required to pay higher interest rates and/or pledge a greater amount of collateral.

At the higher end of the range between 40% and 55%, lenders will view you as being over extended and would consider giving you a loan to be very risky.

Many lenders will consider compensating factors in evaluating the capacity and credit worthiness of applicants that have high debt to income ratios. Compensating factors such as the following may help you obtain favorable consideration even with a high debt to income ratio:

- Proven ability to manage a high debt ratio and maintain a satisfactory repayment history with creditors.
- Proven ability to save and/or have large amount of savings or liquid investments.
- A debt with only a few payments left.
- Collateral value that far exceeds the loan amount.

In this debt to income range, it is likely that you will have to reduce debt before you can make any major purchases with new credit. You may want to consider consolidating some or all of your debt into one loan. While this might lower your monthly payments, it will probably extend the amount of time it will take to pay off your current debt, often by several years. Depending on the amount you consolidate, you may be required to pledge collateral such as the equity in your home or other personal assets that you own.

If only a partial debt consolidation is done, the money saved can be used to pay off other debt. You should always pick the accounts with the highest interest rates to pay off first.

Another option would be to divert some of your discretionary spending toward debt repayment. It is recommended that when one account is paid off, you should use the funds from that payment to payoff another account. Once you have some of the debts paid off, it will be easier for you to obtain new credit for major purchases without being considered a high credit risk.

Remember that your debt to income ratio is not the only criteria used by lenders to evaluate your creditworthiness. Additional factors include your credit score, and in some instances, any collateral you have to offer to reduce the lender's risk in case of default. These and other personal factors are evaluated according to each lender's policies and preferences.

These tips are offered in hopes that each person will understand and teach the next person around them how to maintain good habits and learn from any bad experiences they may have had are going thru.