

How to Get a Mortgage With Poor or Bad Credit





Buying a house in today's market can seem hopeless for people with low credit scores.

Some 21 percent of Americans have scores below 600, which is considered subprime, according to credit bureau Experian. Even the average credit score, 675, is too low to qualify for the best rates on conventional [mortgages](#).

The good news is that it's possible to buy property with an average or even poor credit score. In fact, government programs including FHA and VA loans, as well as lenders that specialize in lower credit such as Carrington and Quicken Loans, are making home loans more accessible for the credit challenged.

"Just because you have a low credit score doesn't mean you can't purchase a home. There are a lot of options out there for consumers with low FICO scores," says Randy Hopper, senior vice president of mortgage lending for Navy Federal Credit Union.

Offset credit problems with cash

Most lenders consider three things when deciding whether to approve your mortgage application: debt-to-income ratio, credit score and loan-to-value ratio, or LTV.

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You might be able to offset a poor credit score with a larger down payment, thus improving the LTV. A larger down payment can also help make you more attractive to lenders, since you'll need to borrow less money for the purchase and have more equity in the home.

Some people with poor credit turn to friends or relatives for down payment money. Lenders are okay with this but may require a letter from the person who put up the cash stating that it's a gift. If you get a cash gift, make sure you deposit that money in your bank account as soon as possible.

"The lender has to know where that money came from, so let it season in an account for at least 60 days. Otherwise you might not be able to use it right away," Bill Banfield, executive vice president of capital markets for Quicken Loans, says.

Take advantage of government-backed programs

If you go outside of conventional loans, such as FHA or VA programs, your down-payment obligations shrink or disappear altogether.

"One of the largest financial advisor firms in the country wrote a blog which stated that to get a mortgage you need to have 20 percent down," Banfield says. "And I remember thinking 'man this myth of how much money you need down really sticks around.' It's just not true."

The VA program doesn't always require a down payment and FHA loans require 3.5 percent. Plus, they have no minimum credit qualifications.

Another benefit of FHA and VA loans is that the rates are on par, or sometimes even lower, than conventional loans.

"The best option is to go with an FHA or VA loan because they're not risk-based priced," Hopper says. "If you go with a lender's program, in all likelihood, that product is going to be a risk-based priced loan and you'll end up paying higher rates."

One drawback of an FHA and VA loan is that they have stricter loan limits. This means you might have to get a less-expensive house or wait until your credit is in better shape to buy.

Another hitch is that, unlike conventional mortgages, FHA loans require mortgage insurance, or MIP. FHA borrowers can pay the MIP in two ways: upfront as part of the closing costs or roll it into their monthly mortgage payments.

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If you pay the MIP at closing, the cost is 1.75 percent of the FHA loan amount. So on a \$150,000 loan you'll pay \$2,625. If you add it to your mortgage payment, then you'll pay a percentage each month which is based on the expected average outstanding balance during the year.

Depending on your down payment, terms and LTV, the annual MIP can range from 0.45 percent to 1.05 percent. FHA borrowers must pay MIP throughout the life of the loan. However, the burden is lessened as the balance shrinks.

"With FHA you're going to have to get life-of-the-loan mortgage insurance, which isn't required with conventional loans. So, the total cost of financing is going to be higher with an FHA program," Banfield says. "The benefit is maybe you don't have adjustments based on credit scores."

Understand your credit to understand your options

A key step in the home-buying process is understanding your credit. Start by finding a mortgage lender you trust who can guide you through this process. For people struggling with their finances, big banks might not be the way to go. They often stick with conventional products which you might not qualify for.

Credit unions, mortgage lenders and community banks, however, have a reputation for helping buyers with mediocre or poor credit scores.

For example, Navy Federal Credit Union has no minimum credit score requirement. Instead, says Hopper, they look at the entire financial picture of an applicant.

"We don't just weigh your credit score, we look at cash flow, earnings and your history of repaying loans. We also look at assets," Hopper says.

Knowing your financial status will give you important insights into how much you can afford, what you will pay in fees and what your interest rate might be. It will also give you a chance to decide your next steps.

"We always recommend starting the home buying process 90 days prior to when you want to shop, because 90 days is several monthly cycles to get your credit in order," Hopper says.

Experts agree that once your credit score dips below the 700 range, rates are going to rise.

"Below 680 is when the friction starts and as you get down to 620 it gets increasingly difficult. The fees are going to go up and the ability for you to get a lower down payment mortgage is going to be hard," says Banfield.

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Using myFICO.com's loan savings calculator, here's how much you'd pay at today's rates for each credit score range. Examples are based on national averages for a 30-year fixed loan of \$200,000.

How your credit score impacts interest rates and payments

760–850	4.17%	\$975	\$150,833
700–759	4.392%	\$1,001	\$160,208
680–699	4.569%	\$1,022	\$167,771
660–679	4.783%	\$1,047	\$177,020
640–659	5.213%	\$1,100	\$195,938
620–639	5.759%	\$1,168	\$220,584

If you're among the many Americans with a below average FICO score, you have options. You can choose an FHA loan or repair your credit and wait to get a conventional mortgage.

"That's the beauty of credit, it's something you can control. You can take action, such as making sure you pay your bills on time, paying down your balances and not taking out more credit," says Banfield.

Repairing credit is easier than many think

You're in the market for a mortgage or other type of loan, but are consistently turned down. Or, you do get a loan offer, but the interest rate is staggering. Most likely your credit score is the culprit.

The higher your score, the better your chances of obtaining a loan, and the better your rates and terms. Here's how to improve your credit score fast so that you can get the loan you need.

Check for errors on your credit report

If you've regularly paid your bills on time and never had any issues with lenders or credit card companies, yet you have a low credit score, it could be that there's a mistake on your credit report.

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According to a Federal Trade Commission study in 2012, about 25 percent of people had some error on their credit report, which had a negative effect on their score.

The credit reporting agencies corrected errors for about 20 percent of consumers who reported them while about 1 percent of those who reported errors saw a change in their credit score after the mistakes were corrected. In some cases, individual scores went up by 25 points. In very rare cases (1 in 250), a person's score went up by more than 100 points.

You're allowed to review your credit report for free once a year with each of the three credit reporting bureaus — Equifax, Experian and TransUnion. You can get access to your free credit reports by visiting AnnualCreditReport.com.

Start paying on time

In some cases, a low score is a result of your payment habits. Your payment history has a big effect on your score.

According to the Fair Isaac Corp., which calculates the FICO score, payment history makes up 35 percent of your score. If you aren't already in the habit of paying your debts on time, doing so can improve your credit score quickly.

Keep balances low

How much you owe makes up 30 percent of your FICO score. The less you owe in comparison to what you could borrow, the higher your score.

One trick to try is to pay your balances off before the closing date of your [credit card](#) statement. If you charge \$1,000 to one card during a month, but pay the balance in full before the statement period ends, the credit card will report that you owe nothing, making it look as if you're not using your credit at all.

Even if you can't pay the entire balance off before the statement closing date, try to keep the amount you charge less than 30 percent of the amount of credit available. That means if your limit is \$10,000, you want to charge no more than \$3,000 over the course of a single billing period. Keeping your balance below 10 percent of your total available credit will improve your credit score even more.

Be cautious about new credit

Your credit score drops a bit every time you open a new credit card or other account. If you're wondering how to improve your credit score fast, one option is to be cautious about opening new accounts or cards.

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The one exception to this is if you don't have much of a credit history and need a [credit card](#) to get started. In some cases, opening a new account can help improve your credit mix, raising your score in the long run. Only opening new credit accounts when absolutely necessary will help you improve and maintain your credit score.

Also, be careful about closing credit cards you've paid off because it can lower your credit score. Closing a card causes your available credit to drop, reducing your borrowing power.

Conclusion

A good credit score is above 700. Very good scores are above 740 and exceptional scores are above 800. Raising your scores after a blemish on your credit report or building credit for the first time will take patience and discipline. You can expect it to take a few months to two years to build a good credit score, but you can hasten the improvement by following Bankrate's strategy.