

## Borrowers: Beware the Second Credit Report

**Congratulations!** You've been *approved for a mortgage*<sup>1</sup>. Now you can submit an offer for that four-bedroom colonial dream house with confidence. Better start picking out new drapes.

Not so fast.

Your lender might be checking up on you up until the day you close – and that letter of approval may not be the last word on your loan.

Fannie Mae's new Loan Quality Initiative, which took effect June 1, is part of the mortgage giant's effort to improve loan quality and cut down on the kind of shoddy underwriting that helped crush the housing market, and ultimately make it unnecessary for there to be so many loan repurchases, says Janis Smith, a Fannie Mae spokeswoman.

It's essentially another measure to tighten underwriting standards. "Foreclosures are so numerous now, that Fannie and Freddie are in a rolling credit-tightening panic trying to never again make a loan that is going into default," says Lou Barnes, a mortgage banker in Boulder, Colo. And the initiative, he says, will probably "blow up an unknown number of closings because of mistaken or ambiguous findings in new credit reports."

Part of the *LQI*<sup>2</sup> requires any lender that sells its mortgages to Fannie Mae to determine that "borrower liabilities incurred up to, and concurrent with, closing are disclosed and evaluated in qualifying the borrower for the loan." (As of the first quarter of 2010, Fannie created 40.8% of new single-family mortgage-related securities, up from 38.9% in the prior quarter.)

But exactly how lenders go about doing this is up to them. In many cases, it will entail a "refreshed" credit report pulled immediately before a borrower's closing date.

"You will see – as quality control – lenders re-pulling credit reports just prior to closing the loan," says Bruce Brown, a certified mortgage planning specialist at Pulaski Bank Home Lending in Kansas City, Mo. And any newly opened lines of credit could put the transaction in jeopardy.

Here's where buyers can potentially hit a snag:

### Debt-to-income ratio

Applying for credit of any type – for a new washer-dryer at Sears for the new house, a new car, or a new credit card – between the date of your loan approval and closing could snag the deal.

That's because the new lines of credit might be sizable enough to affect your debt-to-income ratio. (The debt-to-income ratio is the percentage of your monthly gross income used to pay your monthly debts, and is one of the tools that lenders use to determine loan eligibility.) That additional debt might push you over Fannie's debt ratio threshold of 45%.

For example, if you bring in \$10,000 a month and you spend \$4,500 on minimum obligations, that's a 45% debt ratio. "If we find out close to the closing that you traded in your old car for a new one and your new car adds \$100 more in monthly payments, you just kicked yourself out of getting approved," says Brown.

Typically, lenders would pull a borrower's credit report when they first apply for the mortgage, but would not pull a new one just prior to closing unless the report had expired.

Now, to be extra diligent, lenders will likely do a last-minute check – either by pulling a second credit report or following up on inquiries noted in the original report. (Inquiries are requests by businesses to check your credit; they show up on a report indicating who pulled your credit report and on what date.)

"It's going to send up a red flag of epic proportions if a lender all of a sudden sees inquiries from Pottery Barn and Home Depot that weren't there in the first credit report," says John Ulzheimer, president of consumer education for Credit.com. "They're going to want to know if you took on more debt."

### Credit score

Another thing borrowers may need to worry about is any changes in their credit score. The LQI requires lenders to resubmit any borrower where "new derogatory information is detected and/or the credit score has materially changed."

So even you took on no new debt, your *credit score*<sup>3</sup> might have dropped from the time of the first credit report to the second – say, because of a credit inquiry from a car-rental agency or a late payment on your cable bill. If you started out with a credit score of 742 – a score which qualifies you for the best rates – and then drop to 739 before closing, that could negatively affect your loan terms, Brown says.

## Losing your deposit

Running a last-minute credit check could delay the closing and in a worst-case scenario scuttle the loan altogether, says Richard Vetstein, a real estate attorney in Framingham, Mass. Under the terms of standard contracts or "purchase and sale agreements," a borrower who loses financing days before closing because of LQI issues could potentially forfeit his deposit.

Contracts typically include a scheduled closing date. So if there's a delay and the borrower can't close on the assigned date, a seller may end up keeping the deposit, which is typically 5% of the purchase price, says Vetstein.

How can borrowers make sure they don't get tripped up in the new guidelines? Put simply, refrain from obtaining new credit and making big purchases before closing, Vetstein says.

<sup>1</sup><http://www.smartmoney.com/personal-finance/real-estate/7-tips-for-getting-a-preapproved-mortgage/>

<sup>2</sup><https://www.efanniemae.com/sf/lqi/pdf/lqifaqs.pdf>


<sup>3</sup><http://www.smartmoney.com/spending/deals/5-things-that-can-hurt-your-credit-score/>

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