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How to Get a Mortgage With Bad Credit

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Today, there is still a general consensus that to buy a home you need to have 20% down and a good-to-excellent credit history. The good news is you actually don't need a large down payment or great credit in order to purchase a home with competitive market terms.

Let's look at the characteristics of what a mortgage lender deems to be bad credit when it comes time to qualify for a mortgage loan.

Credit Score Scale	
740-800	Outstanding
720-740	Great
700-720	Good
680-700	Mediocre
***620-680**	Less than perfect, but approvable

A mortgage company's definition of bad credit might not be what a consumer considers to be bad credit. A credit score of 620 or higher is required to successfully obtain a mortgage. By the same token, a 620 credit score is considered by a lender to be less than perfect, but it's still possible to get a mortgage with that score.

Your credit score determines *two major things* for a mortgage company:

1. Loan program — whether it's a conventional or FHA-type mortgage
2. Pricing — this includes your interest rate and any additional charges indicative of the credit score (the lower the credit score, the higher the interest rate and/or potential charges)

Your credit history is the next factor in determining whether or not your loan will be approved. Is there a pattern of previous credit delinquencies? Are there balances on closed-out accounts? It's common for a consumer to have a 620 credit score, and have a consistent historical pattern of derogatory credit. Interestingly, this person would have a more difficult time obtaining mortgage loan approval than someone with a 640 credit score with no history of delinquencies other than a foreclosure from a couple of years before.

In order of priority, lenders will look at the credit score to determine which home loan you're eligible for. Next, the complete credit overview will be taken into consideration to determine what questions may or may not arise in the underwriting decision process. The underwriting process will be looking for "what happened," "why it happened" and the future "likelihood of continuance or repeat non-repayment."

Common Credit Red Flags for Lenders

Pattern of Delinquencies — A record of late payments is possible to work around, but more lender scrutiny will be given to the size of your down payment and your debt-to-income percentage.

***Student Loan Late* Payments** — If you had a late payment on your student loans within the past 12 months, you may be more likely to be approved for conventional financing. Government financing — like FHA — does not take kindly to delinquent federal debt.

Mortgage Late Payments -- One late payment in the past 12 months is permitted, so long as it can be explained and, if necessary, fully documented.

Short sale – It takes 36 months from the date of the short sale until you're eligible using a 3.5% down payment FHA loan; 24 months with the VA loan; 24 months on a conventional loan with a minimum down payment of 20%.

Bankruptcy – With Chapter 7 (Chapter 13 is less common), you have 24 months from the date of discharge until you're eligible using a 3.5% down FHA loan; 48 months on VA loans (still no money down required); and 48 months on conventional loans, no matter the down payment.

Why You Can Get a Mortgage With Bad Credit

There's a thing called investor overlays, which are adjustments to guidelines and/or pricing created in favor of the lender. This is precisely why one lender can do a loan for someone with bad credit and minimal (or no) down payment, and another lender cannot do the loan in some instances.

Overlays further protect lenders against potential future losses from the home loans they originate, preserving profit margins and buyback risk (an event in which the originating lender is forced to buy back from the investor if the loan they made was not fully documented). Investor overlays tighten the screws on borrowers' ability to borrow. Put another way, it shifts risk — which translates to cost — on to the consumer by means of limiting the ability to borrow via higher loan fees, reduced purchase price, or lower debt ratio, to name a few.

Note: Every mortgage lender has investor overlays, it's the nature of how mortgage companies operate, the key is to work with a lender whose overlays are minimal.

Homebuyer Homework

1. Know your credit score, first and foremost (you can monitor your score for free using a service like Credit.com's Credit Report Card). Obtain a copy of your credit report (which you can do for free through AnnualCreditReport.com), this will aid you in selecting the appropriate lender.
2. Get as much supporting documentation as possible surrounding your credit challenges so the story can be explained from A to Z.
3. When speaking with a potential lender, be very specific. Do not be afraid to share every detail of your needs and concerns, giving the most complete description possible. Find out upfront if they have any additional conditions with regard to credit history, as doing so could save you considerable time and money.

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