The Importance of Good Credit

CreditSmart® Asian

Freddie Mac

We make home possible®

About Freddie Mac

Freddie Mac is a stockholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders in support of homeownership and rental housing. Freddie Mac purchases mortgages from lenders and packages them into securities that are sold to investors. Since its creation, Freddie Mac has helped finance one in six American homes.

About CreditSmart® Asian

CreditSmart Asian is a multilingual series to guide Asian American consumers on how to build and maintain better credit, understand the steps to buying a home and how to protect their investment.

Special Thanks

Special thanks to the following organizations for their collaboration in the development of the CreditSmart Asian: Asian Americans for Equality, Boat People SOS, Chhaya CDC, Filipinos for Affirmative Action, Korean Churches for Community Development, Nakatomi & Associates, National Coalition for Asian Pacific American Community Development (National CAPACD), National Congress of Vietnamese Americans, National Korean American Service & Education Consortium, Inc., and Quon Design.

Freddie Mac:
The Importance of Good Credit

- Open bank accounts
- Apply for a credit card
- Keep records of repayment and income
- Use credit card responsibly over time
- Make payments before due date
- File income taxes
- Know your rights as a borrower
- Build your good credit rating

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CreditSmart® Asian

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Credit Smart® Asian: The Importance of Good Credit

Welcome,

For millions of families, homeownership is a route to creating wealth. It builds financial security for the future.

As you begin the journey to homeownership, Freddie Mac is providing this information to help you successfully make your way through the process. We know the process may seem daunting, especially if you have limited English skills or if you don't yet have credit established and don't know how the system works. We created this series of guidebooks to help you get started. The guidebooks cover the importance of establishing your credit, the process of buying a home, including how to make the best financial choices for you and your family, and the responsibilities of being a homeowner.

Positive credit is an asset that will fuel your future wealth.

There are many other resources available to you, including community organizations, your local government housing agencies, real estate agents and lenders who understand and are willing to work with prospective homebuyers like you. We strongly encourage you to seek out their professional services to gather the facts so you can make the best decisions. You will face many choices throughout the process.

In this first guidebook, *The Importance of Good Credit,* you will learn the significance of establishing and maintaining a good credit history. Even if you don't have a checking account or a credit card, you will learn how and where to begin. Yes, it takes time, but establishing your good credit history is worth it. Good credit is an asset that will fuel your future wealth by allowing you to secure a loan for a car or for your business and to buy a home where your family can live and grow together.

After reading this booklet, you should read our companion guidebooks, *Steps to Homeownership* and *Homeowner Benefits and Responsibilities.* Together, these books are a valuable road map addressing the issues and questions most important to you.

From all of us at Freddie Mac, we wish you great success. With proper planning, time and hard work, you can realize your dream of homeownership.

Good Credit: A Gift for the Future

You work hard. You strive to live within your means and to manage your money and financial resources responsibly. Saving for the future is very important to you and your family. Now you are ready to give your family a valuable gift: a home, a place to live and grow together and an important **asset** for the future. Homeownership means building a path to financial security and stability for your family and the future.

In the United States, most people must borrow money from a lending institution to purchase their home. As you begin the process of buying your own home, you will discover the importance of having good **credit**, especially when you try to get the best financing option. Today, lenders consider many factors when deciding whether to give you a home **mortgage** and what interest rate your mortgage will be. Your **credit history** is one of the primary sources lenders use to determine your likelihood to pay back a loan.

Your credit history is a report on how you have paid bills or paid back money you have borrowed. It includes your loans, your credit card accounts with banks, stores and other lenders, your record of payments and your timeliness of payments. Your credit history will only show how you paid bills or used credit if the lender reported your payment history to the credit reporting bureau.

If you do not have a credit history—perhaps because you do not use traditional bank services or credit cards or your payments were not reported to a credit bureau—or if you have imperfect credit because of past problems, you may face challenges when buying a home.

Fortunately, you can learn how to establish and build your good credit history. Yes, it takes time. But by building a good credit history now, you will be well on your way to homeownership and have the tools for building wealth. Also, a good credit history can save you thousands of dollars in the future.

By building a good credit history now, you will be well on your way to homeownership and have the tools for building wealth.

WHY IS GOOD CREDIT IMPORTANT?

Good credit helps you realize your dreams. Buying a home, buying a car, leasing an apartment, getting a job—all these events may require a credit check.

Perhaps you want to make a major purchase with credit, such as a new computer or an appliance for your home? Or perhaps you want a loan so you can go to college or send your child to school? All these important life events are made easier if you have good credit. Once you establish good credit, you receive preferred rates on other transactions, such as lower premiums on auto and **homeowner's insurance.**

Credit is the ability to borrow tomorrow's money to pay for something you get today.

What Is Credit?

Credit is the ability to borrow tomorrow's money to pay for something you get today, such as a home, furniture or car. It is a promise to repay a **debt**, and it reflects on your reputation. Credit may be extended through credit cards, personal loans, car loans and home mortgages.

Two types of credit are revolving credit and installment credit.

1. Revolving credit allows you to borrow up to a pre-established limit repeatedly, as long as you keep the account in good standing. Revolving credit includes credit cards and home equity lines of credit. For example, if you have a $1,000 limit on your revolving line of credit, you can borrow $800, repay it, then borrow $900, repay it and continue the cycle as long as you wish. With your responsible use and repayment, your bank may increase the limit on your revolving line of credit from time to time.

2. Installment credit is a loan provided to a borrower by a lender to be repaid over a specified term. Installment credit includes car loans and personal loans. For example, you might borrow $20,000 to buy a car and receive a 5-year loan term for repayment. Loans that are secured by an asset (for example, your car) usually have a lower interest rate than unsecured loans.

Interest Rates

Interest is a charge you pay to borrow money from your lender. The interest rate is usually expressed as a percentage of the amount borrowed. The interest you pay is the cost of your loan over the term of your loan. The **annual percentage rate**, or APR, is the total annual cost you pay (including the interest rate, **points** and fees) as the borrower on your loan. According to federal law, lenders must report the APR to you for a home mortgage loan. The APR is a good tool for comparing rates on different loans.

SECURED VS. UNSECURED LOANS

Some loans are called "secured," meaning they are backed by **collateral**. Collateral is the value of an item of property, such as a car, a home or a cash account. For example, home and car loans are guaranteed by the item purchased. In the case of a secured credit card, your purchases are guaranteed by a deposit account equal to your line of credit. If you fail to repay a secured loan, your lender may take your collateral to satisfy the debt—by **foreclosing** on your home, repossessing your car or deducting from your cash account.

Other loans, such as traditional credit cards or student loans for higher education, are unsecured by collateral. Even though you do not have collateral guaranteeing repayment, you still are obligated to satisfy your loan terms. Lenders may take legal action to force repayment if you **default** on an unsecured loan.

Good debt is money borrowed for an asset that retains value, or even builds value.

Can Debt Ever Be Good?

You may prefer to pay for your purchases and bills with cash because you do not want to incur debt. It might seem strange to say there is such a thing as good debt when you have spent much of your life trying not to borrow money. When it comes to establishing your good credit, there really is such a thing as good debt. There are also some types of debt you should avoid. In general, banks and lenders look favorably upon good debt that is managed well.

Good debt is money borrowed for an asset that retains value, or even builds value (also called **equity**), or for something that will improve your standard of living in a meaningful way—such as a loan for higher education that will enable you to get a higher-paying job in the future. Examples of good debt include a home mortgage on your principal residence, a loan to help start or expand your business, a car loan so you have a vehicle to get to and from work or school, or a home equity loan to improve and add value to the residence that you own.

Avoid borrowing money for incidental items that do not retain their value. For example, unless you can pay off the credit card balance each month, avoid using high-interest credit cards to pay for meals or clothing that you really do not need. With the realities of credit cards, an incidental $50 item of clothing paid for with credit today and not repaid immediately could cost many times its original purchase price when it is finally repaid. And chances are, the item of clothing will not last as long as the debt!

DO I REALLY NEED THIS?

Today, there are many consumers in serious debt because of overuse of credit cards for nonessential purchases. To ensure you do not become one of them, it is important to evaluate each purchase carefully before you buy it with credit. Ask yourself these questions:

- Do I really need this item?
- Do I need to buy it today, or can I wait to purchase it later with cash?
- What will this item really cost me after I pay it back over time?
- How long will it last?
- Decide what you can live without for now—especially knowing that being responsible with your credit will help you realize your greater dream of homeownership.

Be sure you know all the terms of your loan before you sign any agreement.

FORMS OF CREDIT TO AVOID

As a responsible consumer, you must be aware of tactics used by some creditors that promote easy loans regardless of your ability to repay. While they may seem attractive, these loans typically involve high interest rates, some form of collateral or even costly hidden fees. For example, avoid pawnshop loans and agreements with local rent-to-own stores, which charge you exorbitant interest rates via long-term rental agreements for furniture or other household items. Also avoid payday and tax refund advances, which may have high upfront fees.

Be sure you know all the terms of your loan before you sign any agreement. With a little research or a few phone calls, you may discover that you can do much better by borrowing money from a local bank or a traditional lender.

Good Credit Is Worth It

With good credit, you will receive preferable interest rates and pay lower fees.

Now that you understand the basic types of credit and interest, you are ready to establish your good credit history. It is a large part of your financial reputation, and it is examined when you apply for any loan in the future—such as for a new home or car—and perhaps when you apply for a job.

With good credit, you will receive preferable interest rates and pay lower fees. Over time, you will see this for yourself. As your good credit history grows, you will have an easier time getting a loan approved, and you will receive favorable rates and terms. Your auto and home insurance premiums may even go down as your credit rating goes up.

With good credit and early preparation, you can buy a home for your family—a thing of value that builds equity. Equity is the difference between the value of your home (if you sold it today) and your outstanding loan balance. For example, if you buy a home for $210,000 today and own it for five years, the home likely will increase in value. Your home may be worth $400,000. If you sold the home for $400,000 while owing only $200,000 on your mortgage, you would have $200,000 in equity ($400,000 – $200,000 = $200,000).

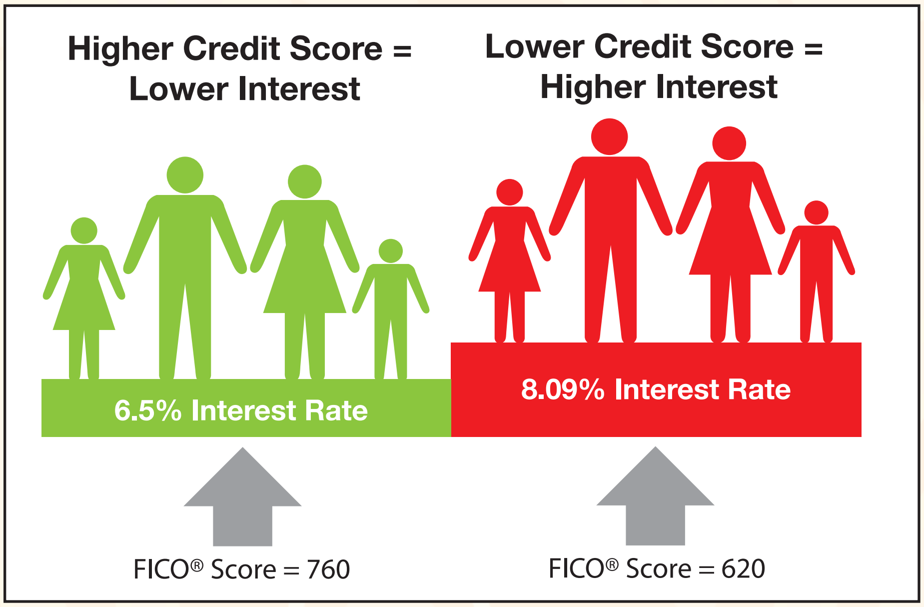
Your home's equity is a valuable tool for building wealth for the future of your family. You can use the equity to purchase a larger home, or you can borrow against the equity to improve your property. Your home's equity may even fund your business, retirement or your children's education.

Other advantages of homeownership include valuable tax benefits, such as being able to deduct your mortgage interest payments on your annual income tax return if you itemize your tax deductions. Another advantage is having the same monthly mortgage payment over the life of your loan (if you have a **fixed-rate mortgage**). If you are a renter who has ever experienced an unexpected rent increase, you can easily see the value of this.

Believe it or not, there are also advantages to using credit cards for your regular purchases (provided you pay off your balance each month). Carrying large amounts of cash to make purchases is dangerous. Cash cannot be replaced if lost or stolen, while most credit cards offer some form of protection if your card is reported stolen or missing. When you use a credit card, you may receive some form of buyer protection if you purchase an item that is defective. Credit cards also offer a way to track your purchases via your monthly statement—giving you an effective way to track expenses for your household or small business.

WHY DOES IT MATTER?

Good credit is a valuable asset. Consider this example of two families trying to get a fixed-rate, 30-year home mortgage for $216,000:



Based on 30 year fixed-rate mortgage of $216,000

If your FICO score is		Your interest rate is		Your monthly payment is
760-850	=	6.50%	=	$1,366
700-759	=	6.72%	=	$1,397
680-699	=	6.90%	=	$1,423
660-679	=	7.12%	=	$1,454
640-659	=	7.55%	=	$1,517
620-639	=	8.09%	=	$1,599

These interest rates and scores are for illustration only; actual mortgage rates depend on many variables, including credit scoring.

- The first family, with a **high credit score of 760**, is pleased to receive a **6.5%** interest rate.
- The second family, with a **lower credit rating of 620**, is offered a rate of **8.09%**.
- The 1.59% difference may not seem like a lot now, **but it will cost the second family $2,796 a year more—$83,880 over the life of the loan—** for their mortgage.

These interest rates and scores are for illustration only; actual mortgage rates depend on many variables, including credit scoring.

Building Good Credit

You can create a non-traditional credit history by showing careful documentation of your payment history.

Now that you can see the value of building a strong credit history, you are ready to begin building your own good credit. But where do you begin, especially if you have no credit now? The good news is that you can do it. With patience and a little time, you will have a credit history to build your future upon.

The first step is to open a checking or savings account if you have not done so. Next, apply for a credit card. If you cannot open a bank account or have a credit card now, you must begin keeping track of all your financial obligations. (Why? Some lenders are realizing the value of serving new immigrants and those with cash incomes. You can create a non-traditional credit history by showing careful documentation of your payment history.) Here are some things you can do to start establishing your good credit:

1. Open checking and savings accounts. (If you do not speak English, look for a bank branch or credit union with bilingual tellers where you will feel comfortable doing business.) Keeping all your money in cash in your home or place of business is dangerous, leaving you at risk for losing your money or having it stolen. Your cash is safer in the bank. In banks and credit unions, your deposits are insured against loss. (Limits on insurance vary by institution and type of account. Ask your financial institution for its deposit insurance information.) If your money is in a bank, you can pay bills, make withdrawals and check your balance regularly. Your bank also may offer value-added services, such as free or low-cost money transfers so you can avoid expensive wire transfers when sending money to family overseas. If you pay your bills with checks you can show a mortgage lender your history of good payments even if those payments are not reported to a credit bureau. Also your deposits may earn valuable interest.

2. Apply for a credit card. A good place to start is with a department store where you shop regularly. Start with a low balance, and pay your bill on time every month. Another option is opening a secured credit card, which is guaranteed by a savings account equal to the amount of your credit limit. Be careful to avoid upfront fees on credit cards aimed at users with imperfect credit or no credit. Other than an annual fee, there should be no charge to help open a credit card account. Ask your lender to waive or reduce fees, and shop around to find the lowest rates possible. Keep the number of your credit cards to a minimum of two or three. Having too many credit cards can penalize you when you apply for a loan. Pay your rent and utilities on time. Even though these obligations are not typically reported to a **credit bureau** (i.e., Equifax, Experian, TransUnion), if you can show that you paid these bills, then you can show a lender that you have a pattern of making payments on time and in full. If you do not have established credit history, careful documentation of these payments is important.

3. If you borrow money from a family member or friend, keep good records of repayment. If you belong to a cultural savings club (for example referred to by Chinese Americans as "su-su" and by Korean Americans as "kye"), some lenders will accept a letter from the treasurer or the fund administrator as documentation of supplemental funds and a good payment history.

4. Keep your pay stubs. Lenders like to see job stability, and you will need to provide proof of employment. If you do not receive pay stubs, before you apply for credit ask your employer to fill out a VOE (verification of employment) form.

5. If you are self-employed, keep detailed records of your income and expenses.

6. Apply for an open, 30-day credit account. For responsible users, these credit accounts are a useful tool. All your charges are due in full every month, and there is no interest charged. In exchange for your annual fee you are provided with useful consumer benefits, such as purchase protection and travel insurance.

7. Find a friend or family member to be a co-signer. A co-signer may help you qualify for a credit card or loan, but remember that the friend or family member will be responsible for your loan balance if you default on your agreement to repay. (This is important to keep in mind if you are asked to co-sign a loan for someone else.)

Income taxes

If you have not begun to file income taxes, you should begin doing so right away, regardless of your immigration status. The Internal Revenue Service (IRS) offers an individual taxpayer identification number (ITIN) for taxpayers who do not have a Social Security number (SSN). Even if you are not asked for copies of your tax returns now, when you buy a home you will need them. A **mortgage lender** will need to see this documentation of your income and income history to determine whether you can repay the loan.

Chances are you will qualify for deductions (such as for childcare or business expenses) you did not know existed. You even may qualify for a tax refund. Additionally, once you own your home, you will want to deduct your mortgage interest on your tax return—one of the primary advantages of being a homeowner! If you are unsure how to begin, consult the IRS, a tax professional or a local community center for assistance.

JOINT ACCOUNTS—BUILDING GOOD CREDIT TOGETHER

When you apply for credit jointly with your spouse (or another family member), you both are responsible for repayment, and your credit history will be reported jointly. For this reason, it is important to discuss your expectations and goals clearly before opening any new loans or credit accounts. Both of you should set, and agree to, a budget for the use of the credit card or loan, since both of you are responsible for repayment. Remember, you are working together toward your goal of homeownership.

Keeping Your Credit Strong

Pay your bill a few days early to be sure it arrives on time.

Now that you have established credit, you must work diligently to keep it in good standing. Here are some things that will jeopardize your good credit if you are not careful:

1. Late payments. All late payments will be noted on your **credit report**, even if you make up the payment later. You must pay your bill before the due date. When making your payment, be sure to allow for the time it takes your payment to arrive at your lender's office by mail. When in doubt, pay your bill a few days early to be sure it arrives on time. If you miss your due date, you could face costly late fees in addition to the negative credit implications.

2. Borrowing more than the credit limit. If you use your credit card to purchase more than your credit limit allows, you are required to pay the overage plus your normal minimum payment. Additionally, you may be required to pay a penalty fee for exceeding your credit limit. These fees can add up quickly. (If you need additional credit on a regular basis, you should ask your creditor to raise your credit limit. You also should review your spending habits to see if there are any charges you can eliminate or pay for with cash.)

3. Insufficient funds to pay for checks. In addition to incurring expensive bank fees, your returned checks due to insufficient funds may be reported to a credit bureau and may be reflected on your credit rating. Be sure you balance your checkbook, and be sure you have enough cash in your checking account to pay for every check you write. To keep your balance up-to-date, be sure to deduct from your check register all your ATM withdrawals, any fees charged for use of ATMs and any debit card transactions.

4. Defaulting on a loan. An unpaid loan balance reflects negatively on your credit report. You should contact the creditor to see if you can resolve the situation. It is best to resolve the situation, since the negative report will stay on your credit rating until you resolve it.

5. Unpaid liens (collection judgment) or child support. If you owe money because of a legal judgment, it can be reported on your credit history. Resolve these matters before you apply for a home loan. Consult with an attorney or your local legal aid society for assistance.

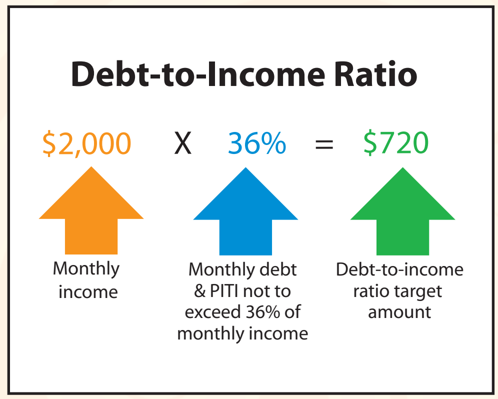
If you miss your due date, you could face costly late fees in addition to the negative credit implications.

6. Guaranteeing a loan for another person that is not paid back. Any loan you co-sign for another person is your responsibility if your co-borrower defaults. Consider these consequences before you co-sign for a friend or relative.

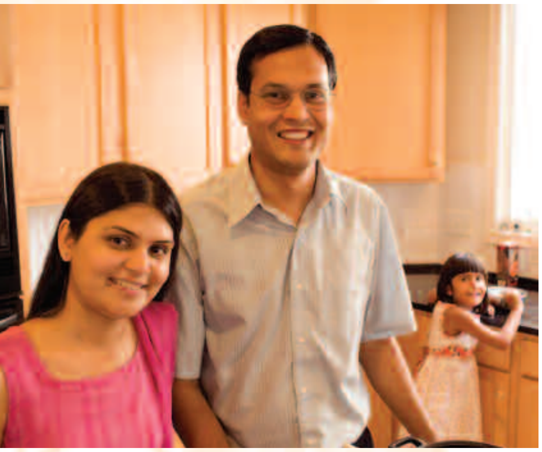
7. Excessive credit inquiries. When you are shopping for a car loan or a home loan, be sure to comparison shop within a short period of time such as two weeks. If you apply for credit with many lenders over a long period of time, it can hurt your credit report. Many inquiries for credit with different lenders over a long period of time may look like you are being denied for credit or that you are looking for too much credit and will not be able to manage it all. You can also obtain your own credit report and your credit score and comparison shop using that information. Tell a lender that these are the facts about you and tell the lender not to obtain a credit report about you at this early comparison shopping stage. A lender will want to verify the credit information later once you are more interested in what they have to offer.

8. Too much debt. Banks and lenders consider your total debt when deciding if you qualify for a mortgage loan. Although it depends on the mortgage, as a guide 28% of your **gross monthly income** can be used for your principal, interest, property taxes and insurance (PITI). Furthermore, your total monthly debt and PITI should not exceed 36% of your total gross monthly income (before payroll deductions). For example, if your monthly income is $2,000, then $720 is the target amount. While this is only a guideline, if your **debt-to-income ratio** is above 36%, you need to increase your income or reduce the amount you owe—or both. Keep in mind that buying a home is an important goal for your entire family, and improving your credit and your overall financial picture is worth the hard work.

9. Job/income instability. Lenders look for borrowers' employment or income stability for at least two years. If you changed jobs several times in the past two years (but remained in the same job industry), or if you were in school prior to working, be prepared to explain your job history to your prospective lender.



You Have Rights



Know your rights and protect yourself from becoming a victim of unscrupulous lending tactics.

With so many things to watch for, it is easy to be confused by credit and loan applications. You may be unsure of the process and even more confused if you are turned down for a loan or a credit card. The good news is that you have rights as a consumer at every step of the process.

Under the **Equal Credit Opportunity Act,** you cannot be declined credit or given a different rate because of your race, gender, marital status, religion, age, national origin or the receipt of public assistance. Public assistance must be considered in the same manner as other forms of income. Under this law, if you are declined credit, you have the right to know why. (Ask for a written explanation, or ask to speak with someone on the telephone to explain the reason your application was turned down.)

Under the **Fair Credit Reporting Act**, you have the right to know what information credit bureaus are distributing about you, and you are entitled to that information being correct.

Under the **Truth-in-Lending Act,** lenders are required to provide you with written disclosures about the cost of credit and the terms of repayment before you enter into the transaction.

Under the **Fair Credit Billing Act**, procedures are provided for resolving billing errors on your credit card account.

The bottom line is that you have important rights as a borrower for every loan transaction you enter. Know your rights and protect yourself from becoming a victim of unscrupulous lending tactics.

CREDIT CARD TERMS

Whenever you apply for a new line of credit or answer an offer for a credit card, you should find a box listing the interest rate, grace period and annual fee, among other information. This box is required by law and should look something like this:

ANYBANK U.S.A. DISCLOSURES	
Annual percentage rate (APR) for purchases	0.00% for 12 months from date of account opening. After that, 10.99% variable.
Other APRs	Balance transfer APR; As long as first balance transfer is completed within 12 months from date of account opening, 0.00% for 12 months from date of first balance transfer. After that, 10.99% variable. Cash advance APR: 22.99% variable. Default APR; 31.99% variable, see explanation below.
Variable rate information	Your APRs may vary each billing period. The purchase and balance transfer rate equals the U.S. Prime Rate plus 2.99%. The cash advance rate equals the U.S. Prime rate plus 14.99% , with a minimum cash advance rate of 19.99%. The default rate equals the U.S. Prime Rate plus up to 23.99%.
Grace period for repayment of balances for purchases	Not less than 20 days if you pay your total new balance in full each billing period by the due date.
Method of computing the balance for purchases	Average daily balance (including new purchases)
Annual fees	None.
Minimum finance charge	$0.50
Transaction fee for purchases made in a foreign currency	3% of the amount of each foreign currency purchase after its conversion into U.S. dollars.
Transaction fee for cash advances	3% of the amount of each cash advance, $5 minimum.
Transaction fee for balance transfers	3% of the amount of each balance transfer, $5 minimum, $75 maximum. However, there is no fee with 0.00% APR balance transfer offer described above.
Late fee	$15 on balances up to $100 up to $1000; and $39 on balances of $1000 and over.
Over the credit-line fee	$35

Over-the-limit Fee*

$3,000 $3,500 = $500

Your Credit Limit | Purchases on Credit Card | Over-the-limit Amount

Your monthly billing scenario could be:

Minimum Payment	$100
Over-the-limit amount	$500
Over-the-limit fee	$35
Total due	$635

*These figures are for illustration only; actual payments will vary depending on your credit limit and agreement.

APR: This line explains your annual percentage rate, as well as any promotional period that may apply, such as the length of time you may receive an introductory reduced interest rate.

Other APRs: You may incur a different interest rate and fees for balance transfers or cash advances. These rates are often higher than your regular rate, so be sure you know your terms before you use these account features.

Variable rate information: In this case, the APR is tied to the U.S. Prime Rate. The U.S. Prime Rate is the published rate banks charge their top corporate lenders. Loans made by banks often are priced above or below the prime rate. With this variable rate, your loan rates are adjusted when the U.S. Prime Rate changes.

Grace period: On credit card accounts, this is the period of time (usually 20 to 25 days) when you can pay for your new purchases in full without being charged interest (if there is no previous balance).

Annual fees: You pay your lender this fee simply for maintaining your account. This fee is added to any interest you owe, and it is due even if you have no balance. This fee and any others the bank may charge for this account are included in your APR.

Transaction fee for purchases made in a foreign currency: If you travel frequently, be aware of this extra fee assigned to your foreign purchases. Your lender charges this fee to convert foreign currency to U.S. dollars.

Transaction fee for cash advances: Cash advance fees are expensive. In general, it is not a good idea to use your credit card for cash advances. You should have another source of funds, such as a savings account, set aside for emergencies.

Transaction fee for balance transfers: Balance transfer offers can be enticing, but you must read the disclosures to see what additional fees you may be agreeing to pay. Keep in mind that if a payment is received after the due date (even if it is received within the "grace" period), discounted interested rates will escalate, often to a higher rate than you now pay.

Late fee: Late fees usually are charged as a percentage of the balance owed. It is easy to see how important it is to make your payments on time.

Over the credit-line fee: This is a penalty you pay to your lender for owing more than your credit limit. Be aware that when you are over your limit, you will owe your regular minimum payment, the total amount over your limit and your over-the-limit fee. Keep careful track of your balance to avoid this costly scenario (see chart).

CREDIT REPORTING BASICS

Once you apply for, and establish, your own credit, many lenders or creditors report your history of payments to one or more of the nation's largest three credit bureaus—Equifax, Experian and TransUnion.

Your credit report may be accessed for many reasons. Lenders, credit card companies and department stores may check your file to determine if you are a good risk for additional credit. Additionally, your employer, landlord, insurance agent and cellular phone company, among others, may gain access to your credit file to determine your creditworthiness.

It is important to make sure the items in your file are accurate. Here is a sample credit report showing the information typically listed:

```
1 LEE, JOHN                  *2 9923,WOODBINE,CHICAGO,IL,60693*3 10,N,CAMINO,OAKLAND

                                   TRANS UNION CREDIT REPORT

<FOR>        <SUB NAME>               <MKT SUB>    <INFILE>    <DATE>      <TIME>
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MARRIOT HOTELS                        CONCIERGE
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S P E C I A L   M E S S A G E S
***TRANS-ALERT: INPUT ADDRESS DOES NOT MATCH FILE ADDRESS***
***HAWK-ALERT:VERIFY INPUT…
   CURRENT ADDRESS IS COMMERCIAL
------------------------------------------------------------------------------------------
M O D E L   P R O F I L E             *  *  *  A L E R T  *  *  *
***NEW DELPHI ALERT: SCORE            +775:26,03,06,25 ***
------------------------------------------------------------------------------------------
C R E D I T   S U M M A R Y
PR=1      COL=1     NEG=1     HSTNEG=1-5    TRD=2     RVL=1     INST=1    MTG=0    OPN=0    INQ=2
             HIGH CRED    CRED LIM     BALANCE      PAST DUE     MNTHLY PAY   AVAILABLE
REVOLVING:   $500         $1000        $100         $            $20          90%
INSTALLMENT: $16.0K       $            $12.4K       $1974        $282
TOTALS:      16.5 K       $1000        $12.5K       $1974        $302
------------------------------------------------------------------------------------------
P U B L I C   R E C O R D S
SOUCE        DATE         LIAB         ECOA         ASSETS       PAID         DOCKET#
TYPE                                   COURT LOC                 1/94         PLAINTIFF/ATTORNEY
Z 4932059    8/93 R       13.0K        C            $5000                     93B38521
CHAPTER 11   BANKRUPTCY                CHICAGO,IL   R. SMITH/D. WINSLOW
------------------------------------------------------------------------------------------
C O L L E C T I O N S
SUBNAME      SUBCODE      ECOA          OPENED      CLOSED       $PLACED      CREDITOR MOP
ACCOUNT #                              VERFIFIED                 BALANCE      REMARKS
ADVANCED COL Y 999C0004 I              3/93         3.93F        $2500        ABC BANK     09P
12345                                  2/94A        $1000                     MAKING PAYMENTS
------------------------------------------------------------------------------------------
T R A D E S
SUBNAME      SUBCODE      OPENED       HIGHCRED     TERMS        MAXDELQ      PAYPAT       1-12 MOP
ACCOUNT #                 VERIFIED     CREDLIM      PASTDUE      AMT-MOP      PAYPAT13-24
ECOA COLLATRIL/LOANTYPE CLSD/PD        BALANCE      REMARKS      MO 30/60/90

AMERICAN BK  B 6661001    10/92        $16.0K       60M282       11/93        545543211111 I05
9876543210                2/94A        $1974        $1974 05     1111111
I            NISSAN MAXIMA             $12.4K       *CONTACT SUBSCRIBER       19V          1/ 1/ 5

FILENES      D 3847002    6/89         $500         MINQ20                    1111111111111 R01
2212345678                1/94A        $1000                                  1111111111111
C            /CREDIT CARD              $100                                   48V          0/ 0/ 0
------------------------------------------------------------------------------------------
I N Q U I R I E S
DATE         SUBCODE      SUBNAME                   DATE         SUBCODE      SUBNAME
2/15/94      DCH248       ABC DEPT STORE :          1/7/94       NPH9999      TEST BANK
------------------------------------------------------------------------------------------
E N D   O F   C R E D I T   R E P O R T  —  S E R V I C E D   B Y :
TRANS UNION CORPORATION                                                   810-524-2222
PO  BOX 390, SPRINGFIELD, PA. 19064.
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Lenders, credit card companies and department stores may check your file to determine if you are a good risk for additional credit.

Good credit helps you realize your dreams.

In general, a credit report lists the following:

1. Your name, address, Social Security number (SSN) and date of birth. It also may list your current and previous employers if you provided that information on a credit application.

2. Your credit information, including current and past loans and credit accounts, such as credit cards, student loans, car loans and previous mortgages on which your name and SSN appear. The information will include the date each loan or line of credit was opened, the current loan balance and your recent payment history, including any late or skipped payments, collections or repossessions.

3. Information from public records, including past bankruptcies, foreclosures, tax liens, judgments from lawsuits and past due child support.

4. A list of recent inquiries into your credit made by any lenders from which you have applied for credit.

It is strongly recommended that you review your credit report periodically. Once a year is ideal. The Fair Credit Reporting Act entitles you to one free credit file disclosure in a 12-month period. Call (877) 322-8228 or visit www.annualcreditreport.com to request this free annual disclosure.

Or you can order your report from any one of the credit bureaus listed here:

Equifax
(800) 685-1111 or
www.equifax.com

Experian
(888) 397-3742 or
www.experian.com

TransUnion
(800) 916-8800 or
www.transunion.com

WHY THREE?

Three credit bureaus. Three credit reports. Three different credit scores. Why? It is true that the information on your credit report may differ slightly from one credit bureau to another. This is because not all creditors report their information to the same credit bureaus. For this reason, it is a good idea to order a report from each of the three bureaus or to obtain a combined report that lists data from all three sources. (This type of report may be called a three-in-one report or a "merged" credit report.) Learn more at www.myfico.com.

What If Something Is Wrong?

If you find an error in your credit report, you have the right to correct it. It is crucial that you address the problem as soon as possible, since errors can affect your ability to obtain a loan or affect how much you will have to pay to get a loan in the future.

There are procedures for alerting the credit bureaus about mistakes on your report. On your report, you will find detailed information on the steps you should take to correct any errors. Write the credit bureau to report the problem, and keep a record of what you send.

You can also call the credit reporting agency and they will instruct you regarding any additional steps you must take to resolve your issue. You may be required to send copies of statements or payments to the agency to explain your concern. Additionally, you may be asked to send an explanation of the matter in writing.

By law, a credit bureau must respond to your complaint within 30 days. If the bureau agrees with you, and the item is determined to be inaccurate, your creditor must notify the other credit bureaus about the issue so they can correct your credit history.

If the credit bureau is unable to resolve your complaint, you should contact the specific creditor in question. Keep accurate records of your contact and conversations, and ask that they correct their error and report their correction to the credit bureaus. If they refuse, you have the right to place a brief explanation in your credit file. Limited to 100 words, your statement can explain an unusual situation, such as one in which you refused to pay a bill because an item was defective or not delivered. In this case, the negative item will still appear on your report, but your explanation will accompany it.

Knowing the Score

In addition to your credit history and your credit report, there is another way credit reporting bureaus indicate your creditworthiness. Credit bureaus use a **credit score** which uses statistical data to evaluate information contained on your credit report. Your credit score is based on information from your credit report, and it helps determine the interest rate, terms and fees associated with your loan. It is important to know that factors such as income, age, race, religion, national origin, gender and marital status are not incorporated into a credit score. A good credit score is not related to a high income. People with modest incomes can establish good credit, and people with higher incomes still may need to establish good credit.

Based on computerized models that assign values to the factors listed on your credit report, the process of credit scoring can be complex, but the basic

If you find an error in your credit report, you have the right to correct it.

If you have a good credit score, you will receive preferred interest rates and terms, and your approval process will be faster and easier.

fact is this: the higher your score, the better. The better your credit report — the higher your credit score. If you have a good credit score, you will receive preferred interest rates and terms, and your approval process will be faster and easier. You often will have your choice of lenders and loan offers, whereas a potential borrower with less than perfect credit may have fewer options.

The most common credit score used today is called a FICO (Fair, Isaac & Co.) score. FICO scores are ranked on a scale from 300 to 900 points. Higher scores are associated with a better credit record and therefore are a lower risk to the lender.

When you apply for a loan, you should ask your lender to explain how your credit score was factored into the lending decision and what effect a better score would have on your loan terms or interest rate. Note that credit scoring is just one tool a lender may consider when deciding whether to extend credit or what interest rate and fees to charge. If you have little or no credit history, you may not have enough information on file for a credit score to be calculated. Keep in mind that with time, diligence and responsible use of credit, you will have a good credit history and a credit score to be proud of.

DENIED? WHAT NEXT?

If you are denied credit, do not give up. First, ask for an explanation of why you were turned down. You are entitled to this by law if you ask within 60 days of being denied credit. If you were turned down because of an error in your credit report, report the error to the credit bureau right away. If the denial was because of an unpaid obligation in your credit history, call your creditor to settle the past debt, or work out a payment plan. If the denial was because of your limited credit history, ask your lender if you can establish a "non-traditional" credit history.

"Non-Traditional" Credit History

A borrower will be most successful in showing a lender that they have paid their debts on time as agreed if they can show several months or a year of consecutive payments. These payments can be documented with cancelled checks, copies of transmittals or possibly a letter from the creditor.

Lenders may be willing to take a look at a variety of types of payments. For example, lenders may look at utility payments, cell phone payments, regular deposits into a savings account, regular transmittal of money out of the country to family members, payment of rent even to a family member.

Identity Theft

Today, it is vital that you protect your personal information. With identity theft a very real possibility for all consumers, it is important that you and your family work diligently to protect your personal data. Examples of identity theft include:

- Using another person's name or SSN to open or use a credit card account.
- Opening a cellular phone or utility account using another person's name or identifying information.
- Obtaining a loan in another person's name.
- Opening a bank account in another person's name.

Thankfully, if you are diligent and review your bank and credit card statements regularly, you are likely to spot any suspected fraud early and get it resolved quickly. But the responsibility lies mainly on you, the victim, to report the fraudulent activity.

Here are some steps you can take to avoid identity theft:

- Review all statements (bank, credit card, insurance, mortgage, loans, telephone, etc.) every month. These days, a simple glance at your balance due is not enough. Pay careful attention to any unusual activity or unfamiliar transactions.
- Know when your statements are due. If your bill does not arrive when you expect it, call your credit card company. Be aware of the possibility that a thief has stolen your mail, called your creditor and changed your mailing address to conceal fraudulent activity.
- Never give out personal information, especially your SSN, by phone, via mail or online unless you are initiating the contact. There are many scams that pretend they are doing legitimate business and need your personal information.
- Destroy (by shredding or tearing up) any paperwork that lists your personal information, including receipts, forms, statements and loan or credit card offers.
- Mail your outgoing letters and bill payments at the post office, where they are less likely to be stolen than if you leave them in your home mailbox for pickup.
- Keep your Social Security card at home, separate from your wallet, in a safe place.
- Only carry in your wallet your main form of identification (such as your driver's license) and a limited number of bank or credit cards. The more items you carry, the more items can be lost or stolen from you.

With identity theft a very real possibility for all consumers, it is important that you and your family work diligently to protect your personal data.

Being Credit Wise

It is only with careful management and persistence that you will establish and maintain your good credit history and a good credit score.

Now that you have credit of your own, you must manage it wisely. It is only with careful management and persistence that you will establish and maintain your good credit history and a good credit score. As you move toward your goal of homeownership, here are some important tips to follow when using credit to make purchases.

Don't buy what you cannot afford. Each time you want to make a purchase with a credit card—no matter how large or small the item—consider that you are getting a loan to pay for it. Do you really want to pay 20% more for the privilege of financing your trip to Asia or hosting a large gathering to celebrate your child's first birthday? That is exactly what you are doing if you cannot or do not pay your balance in full each month.

Pay your balance in full—before your grace period ends. Just because you have credit does not mean you have to keep a revolving balance. If you have the means, pay your entire balance due. If you cannot pay your entire balance, try to pay as much as possible.

Pay more than the minimum payment. If you only pay the minimum payment on your credit card every month, it will take you years to pay your balance, and that is if you do not make any additional purchases with the credit card. Always pay more than your minimum payment.

Evaluate your needs versus your wants. Practice delaying nonessential purchases for items you want until you have enough cash to buy them. Use credit only for items you really need. In Asian cultures, certain customs are important and are considered a need. Consider whether having your baby's first birthday celebration for hundreds of people or hosting an elaborate wedding for hundreds of people (including the pre-wedding customs and rituals associated with an Asian wedding) is a need or a want.

Be savvy about credit industry tactics. Credit card companies use many techniques to get you to borrow more money than you need. Enticing promotions to open new accounts ("Apply today and get a free tote bag!" "Open a new account and get 10% off your first day's purchases!") and attractive in-store promotions offering "no interest and no payments for six months," may sway you to open new accounts you do not really need. Although your obligation for payment of this debt starts six months after your purchase, if you do not pay off the balance you may face hefty finance charges when your promotional period ends.

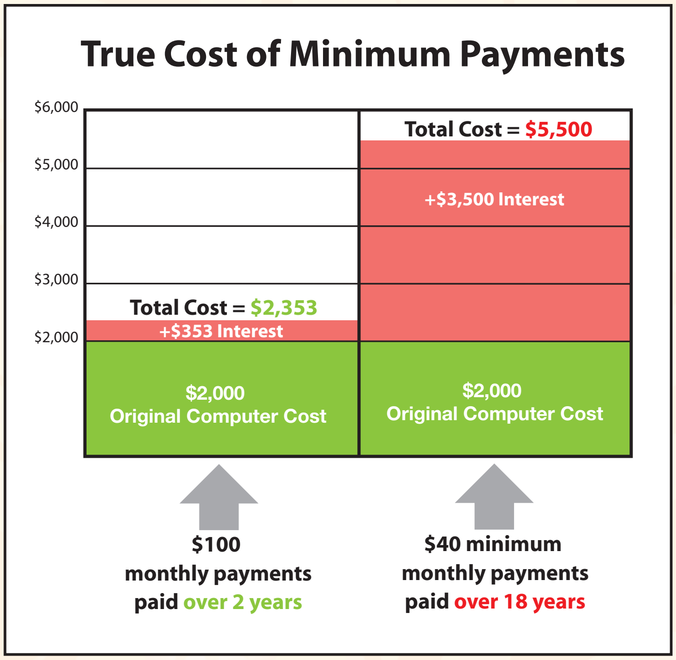
Be wary of special offers. Once you establish credit, you will be offered more credit. Be wary of offers for balance transfers or for new accounts that may contain hidden fees. Be sure to read all the terms before you sign any new credit agreement.

Be aware of fees, fees, fees. From fees for using convenience checks (often included with your monthly credit card statement) to cash advance fees, to charges for optional services like credit insurance or credit monitor-

When you buy an item with credit, over time you pay far more than the purchase price.

ing, you may find yourself incurring fees on top of fees. Always weigh the costs and benefits associated with these types of special services and consider whether you really need them.

Remember your debt-to-income ratio. In general, lenders like to see that your monthly housing expenses do not exceed 28% of your gross monthly income, and that your total monthly debts and housing expenses do not exceed 36% of your monthly income. As you work to establish your good credit, keep this ratio in mind, and keep your spending to a minimum.



The True Cost of Minimum Payments

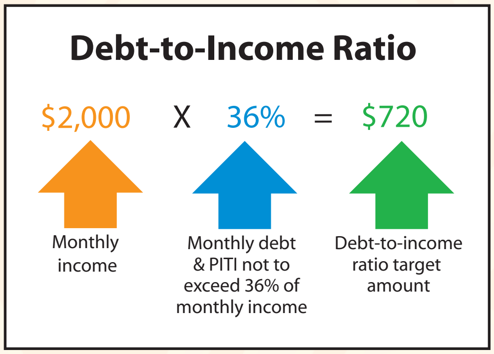
When you buy an item with credit, over time you pay far more than the purchase price. Consider the following example.

Mr. Singh wants to buy a $2,000 personal computer. His children will use the computer for their schoolwork, and Mr. Singh and his wife will use the computer to keep in touch with family around the world.

Mr. Singh decides to use his credit card to pay for the new computer. He knows the importance of paying his bill on time, and he faithfully makes his $40 minimum payment each month. But at 18% interest, it will take Mr. Singh about 18 years and 5 months to pay for that computer—and that is only if he never adds another purchase to his credit card balance. Ultimately, Mr. Singh will have paid more than $3,500 in interest alone. That means Mr. Singh will spend more than 18 years and more than $5,500 for what was a $2,000 computer, which most certainly will be obsolete within a few years of its purchase. By the time the computer is paid in full, Mr. Singh's children might have their own children.

While this purchase was made with the best intentions, it was not a smart financial choice. Mr. Singh would have served his family better by saving $2,000 and paying cash for the computer. Or, if he had to use credit, he should have made a plan to pay far more than the minimum payment each month.

By paying $100 per month and not adding any more purchases to his balance, Mr. Singh would have paid for the computer in only two years, incurring just $353 in interest.



Shop around for the best rates and services when you are ready to apply for a credit card or a loan.

Getting the Credit You Deserve

There are many sources of credit in today's marketplace. As a savvy consumer and borrower, you have more choices than ever before. Be sure to shop around for the best rates and services when you are ready to apply for a credit card account or a loan.

Your first stop should be the bank or credit union where you do business. And you should not stop there. Check at more than one lender before you make a decision. If someone tells you that "Your credit is so difficult that I'm the only person who will work with you" they are most likely not telling you the truth. You also may be a member of an affinity group, such as a community organization, that offers a credit card. As you build your good credit and consider various options, you may want to take advantage of credit cards that offer value-added services, such as travel rewards or points you can redeem for merchandise. Just be aware of any fees associated with the extra services you receive. Also, always compare the interest rates that you pay for these value-added credit cards with the rates for credit cards that do not offer "free" benefits. You may pay more in fees and interest for the free rewards than you would pay if you used cash to buy the trip or merchandise yourself.

Reading the Small Print

Before you accept any credit agreement, you should understand everything on the disclosure. Pay careful attention to any fees associated with extra services or convenience. Credit cards, lines of credit and loans may include annual fees, late payment fees, cash advance fees, balance transfer fees, currency exchange fees and charges for periods when you are not using the available credit. Ask questions if you do not understand the terms, and do not accept the loan if you do not understand, or do not agree to, the terms.

Home Equity Lines of Credit

Once you own a home and have built equity (meaning the home is valued at a higher dollar amount than what you owe on the mortgage), it is easy to think of a home equity line of credit as if it were a credit card, but you must remember that its repayment is guaranteed by your home. Defaulting on a home equity line of credit may put your family home at risk of foreclosure. In general, good uses of a home equity loan or line of credit are to finance projects that increase the value of your home, such as replacing an aging roof or repainting its exterior. Using a home equity line of credit for personal purchases or non-critical expenses, such as a family vacation, is not recommended.

If You Get Into Trouble

To maintain your good credit, you must be vigilant. If you have difficulty making your monthly payments on your loans or credit cards, you must be honest about the problem and recognize your need for help. Here are some warning signs:

- Not paying your bills on time, not even your minimum payments
- Incurring frequent late fees
- Difficulty deciding which bills to pay each month
- Using credit cards for routine purchases that you normally would pay for with cash
- Spending more than 20% of your monthly income on credit card debt and other loans (not including a mortgage)
- Borrowing money to make payments on existing loan obligations
- Being at or near your credit limit
- Paying only the minimum due on your accounts
- Putting off necessities, such as doctor visits, because you don't have the money
- Taking a second job just to afford your basic expenses, such as food and housing

If you recognize these warning signs, you must be honest with yourself about the problem, since it will only get worse with time. Contact your lenders and creditors and explain your situation. You may be able to make repayment arrangements or restructure your debt. Keep detailed records of your communications to protect yourself. Throughout your negotiations, do not make promises to your lenders that you cannot keep. You must be realistic about your financial picture.

It is best to avoid unscrupulous credit repair companies. These companies often make promises they cannot keep, charge you high fees and even may increase your debt. Instead, contact a non-profit, community-based credit counseling organization. A credit counselor can provide confidential budget and debt reduction information, debt repayment programs and financial management education.

BANKRUPTCY, FORECLOSURE, REPOSSESSION

When you have serious problems paying your loan, you may be subject to foreclosure or repossession—meaning your lender may take your car or your home to partially or fully recover the cost of the loan. You may have to declare **bankruptcy**, which is a legal proceeding to alter or eliminate your obligation to repay some or all of your debts. Different types, or chapters, of bankruptcy exist, but you should know that recent changes to bankruptcy laws may require more repayment, and the process is stricter than before. Declaring bankruptcy is a serious action, only to be considered when all other options have been exhausted. A record of bankruptcy will remain on your credit report for up to 10 years.

Good Credit: An Asset for Your Future

Good credit…is a valuable tool for building wealth for you and your family for the long term.

It cannot be stressed strongly enough: Good credit is an asset. It is a valuable tool for building wealth for you and your family for the long term. With good credit, you can make major purchases, you can buy or lease a car, you can get loans for higher education and you can buy your family a home. When you take the time to establish and build good credit over time, you will be able to make purchases securely, unlike using cash, which cannot be replaced if lost or stolen. As you build a credit history, you will be eligible for the best rates and terms on other loans and on things such as cellular phone service and car insurance.

Remember, you have rights as a borrower. You have the right to have an accurate credit report, and you have the right for a creditor to treat you fairly, without consideration of your race, gender, marital status or country of origin.

In turn, you must be a responsible user of credit. You must manage your credit cards, loans and other obligations wisely, paying your bills on time and repaying your debts as promised.

Establishing and maintaining your good credit history is the first step to buying your own home—a place where you and your family can grow together. Yes, it is hard work and possibly time consuming. But, ultimately, it is well worth the effort.

Glossary

Actual Cash Value: An amount equal to the replacement value of damaged property minus depreciation.

Adjustable-Rate Mortgage (ARM): Also known as a variable-rate loan, an ARM usually offers a lower initial rate than a fixed-rate loan. The interest rate can change at a specified time, known as an adjustment period, based on a published index that tracks changes in the current finance market. Indexes used for ARMs include the LIBOR index and the Treasury index. ARMs also have caps, a maximum and minimum that the interest rate can change at each adjustment period.

Adjustment Period: The time between interest rate adjustments for an ARM. There is usually an initial adjustment period, beginning from the start date of the loan and varying from 1 to 10 years. After the first adjustment period, adjustment periods are usually 12 months, which means that the interest rate can change every year.

Amortization: Paying off a loan over the period of time and at the interest rate specified in a loan document. The amortization of a loan includes in each mortgage payment the payment of interest and a part of the amount borrowed.

Amortization Schedule: Provided by mortgage lenders, the schedule shows how, over the term of your mortgage, the principal portion of the mortgage payment increases and the interest portion of the mortgage payment decreases.

Annual Percentage Rate (APR): How much a loan costs annually. The APR includes the interest rate, points, broker fees and certain other credit charges a borrower is required to pay.

Application Fee: The fee to cover processing costs that a mortgage lender charges the borrower to apply for a mortgage.

Appraisal: A professional analysis used to estimate the value of the property. This includes examples of sales of similar properties.

Appraiser: A professional who conducts an analysis of the property, including examples of sales of similar properties, to develop an estimated value of the property. The analysis is called an appraisal.

Appreciation: An increase in the market value of a home due to changing market conditions and/or home improvements.

Arbitration: A process where disputes are settled by referring them to a fair and neutral third party (arbitrator). The disputing parties agree in advance to agree with the decision of the arbitrator. There is a hearing where both parties have an opportunity to be heard, after which the arbitrator makes a decision.

Asbestos: A toxic material that was once used in housing insulation and fireproofing. Because some forms of asbestos have been linked to certain lung diseases, it is no longer used in new homes. However, some older homes may still have asbestos in these materials.

Asset: Something of value an individual owns.

Assumption: A homebuyer's agreement to take the primary responsibility for paying an existing mortgage from a home seller.

Balloon Mortgage: A mortgage with monthly payments based on a 30-year amortization schedule, with the unpaid balance due in a lump sum payment at the end of a specific period of time (usually five or seven years). The mortgage contains an option to "reset" the interest rate to the current market rate and extend the due date if certain conditions are met.

Bankruptcy: A legal declaration that you are unable to pay your debts. Bankruptcy can severely affect your credit record and your ability to borrow money.

Cap: A limit to how much an adjustable rate mortgage's monthly payment or interest rate can increase. A cap protects the borrower from large increases and may be a payment cap, an interest cap, a life-of-loan cap or an annual cap. A payment cap is a limit on the monthly payment. An interest cap is a limit on the amount of the interest rate. A life-of-loan cap restricts the amount the interest rate can increase over the entire term of the loan. An annual cap limits the amount the interest rate can increase during a 12-month period.

Capacity: Your ability to make your mortgage payments on time. This depends on your income and income stability (job history and security), your assets, your savings and the amount of your income that remains each month after you have paid your housing costs, debts and other obligations.

Closing (Closing Date): The completion of the real estate transaction between buyer and seller. The buyer signs the mortgage documents, and the closing costs are paid. It is also known as the settlement date.

Closing Agent: A person who coordinates closing-related activities, such as recording the closing documents and disbursing funds.

Closing Costs: The costs to complete the real estate transaction. These costs are in addition to the price of the home and are paid at closing. They include points, taxes, title insurance, financing costs, items that must be prepaid or escrowed and other costs. Ask your lender for a complete list of closing cost items.

Glossary

Collateral: Property that is used as security for a debt. In the case of a mortgage, the collateral is the house and property.

Commitment Letter: A letter from your lender stating the amount of the mortgage, the number of years to repay the mortgage (the term), the interest rate, the loan origination fee, the annual percentage rate and the monthly charges.

Concession: Something given up or agreed to when negotiating the sale of the house. For example, the sellers may agree to help pay for closing costs.

Condominium: A unit in a multi-unit building. The owner of a condominium unit owns the unit itself and has the right, along with other owners, to use the common areas. The owner does not own the common elements, such as the exterior walls, floors, ceilings or structural systems outside of the unit; the condominium association owns these. There are usually condominium association fees for building maintenance, property upkeep, taxes and insurance on the common areas, and there are reserves for improvements.

Contingency: A plan for something that may occur but is not likely. For example, your offer may be contingent on the home passing a home inspection. If the home does not pass inspection, you are protected.

Counter-offer: An offer made in response to a previous offer. For example, after the buyer presents his or her first offer, the seller may make a counter-offer with a slightly higher sale price.

Credit: Credit is the ability to borrow tomorrow's money to pay for something you get today. Credit is extended based on a lender's good opinion of a person's financial situation and reliability.

Credit Bureau: A company that gathers information on consumers who use credit. The company sells that information to credit lenders in the form of a credit report.

Credit History: A record of credit consisting of a list of individual consumer debts and a record of whether these debts were paid on time or as agreed. Credit institutions have created a detailed document of your credit history called a credit report.

Credit Report: A document used by the credit industry to examine your use of credit. It provides information on money that you have borrowed from credit institutions and your payment history.

Credit Score: A computer-generated number that summarizes your credit profile and predicts the likelihood that you will repay future debts.

Creditworthy: Your ability to qualify for credit and repay debts.

Debt: Money owed from one person or institution to another person or institution.

Debt-to-Income Ratio: The percentage of gross monthly income that goes toward paying your monthly housing expense, alimony, child support, car payments and other installment debts, and payments on revolving or open-ended accounts such as credit cards.

Deed: A legal document transferring ownership or title to a property.

Deed of Trust: A legal document in which the borrower transfers the title to a third party (trustee) to hold as security for the lender. When the loan is paid in full, the trustee transfers title back to the borrower. If the borrower defaults on the loan, the trustee will sell the property and pay the lender the mortgage debt.

Default: Failure to fulfill a legal obligation. A default includes failure to pay a financial obligation, but it also may be a failure to perform some action or service that is non-monetary. For example, when leasing a car, the lessee usually is required to properly maintain the car.

Depreciation: A decline in the value of a home due to changing market conditions or lack of upkeep on the home.

Down Payment: A portion, usually between 3% to 20%, of the price of a home. This portion is not borrowed and is paid up front.

Earnest Money Deposit: The deposit to show that you are committed to buying the home. The deposit is not refunded to you after the seller accepts your offer unless one of the sales contract contingencies is not fulfilled.

Equity: The value of your home above the total amount of liens against your home. If you owe $100,000 on your home, but it is worth $130,000, you have $30,000 of equity.

Escrow: The holding of money or documents by a neutral third party before closing. It also can be an account held by the lender (or servicer) into which a homeowner pays money for taxes and insurance.

Fixed-Rate Mortgage: A mortgage with an interest rate that does not change during the entire term of the loan.

Foreclosure: A legal action that ends all ownership rights in a home when the homeowner fails to make the mortgage payments or is otherwise in default under the terms of the mortgage.

Gift Letter: A letter that a family member writes verifying that he or she has given you a certain amount of money as a gift, and that you do not have to repay it. For some mortgages, you can use this money toward a portion of your down payment.

Good-Faith Estimate: A written statement from the lender itemizing the approximate costs and fees for the mortgage.

Gross Monthly Income: The income you earn in a month before taxes and other deductions. It also may include rental income, self-employment income, income from alimony, child support, public assistance payments, and retirement benefits.

Home Inspection: A professional inspection of a home to determine the condition of the property. The inspection should include an evaluation of the plumbing, heating and cooling systems, roof, wiring, foundation, and pest infestation.

Homeowner's Insurance: A policy that protects you and the lender from fire or flood, which damages the structure of the house; a liability, such as an injury to a visitor to your home; or damage to your personal property, such as your furniture, clothes or appliances

Housing Expense Ratio: The percentage of your gross monthly income that goes toward paying for your housing expenses.

HUD-1 Settlement Statement: A final list of the costs of the mortgage transaction. It states the sales price and down payment, as well as the total settlement costs required from the buyer and seller.

Index: The published index of interest rates used to calculate the interest rate for an ARM. The index is usually an average of the interest rates on a particular type of security, such as the LIBOR.

Individual Retirement Account (IRA): A tax-deferred plan that can help you build money for retirement.

Inflation: An increase in prices.

Inquiry: A request for a copy of your credit report. An inquiry occurs every time you fill out a credit application or request more credit. Too many inquiries on a credit report can hurt your credit score.

Interest: The cost you pay to borrow money. It is the payment you make to a lender for the money it has loaned to you. Interest is usually expressed as a percentage of the amount borrowed.

Keogh Fund: A tax-deferred retirement savings plan for small business owners or self-employed individuals who have earned income from their trade or business. Contributions to the Keogh plan are tax deductible.

Liability: A debt or other financial obligation.

Lien: A claim or charge on property for payment of a debt. With a mortgage, the lender has the right to take the title to your property if you do not make the mortgage payments.

Loan Origination Fee: A fee paid to your mortgage lender for processing the mortgage application. This fee is usually in the form of points. One point equals 1% of the mortgage amount.

Lock-In Rate: A written agreement guaranteeing a specific mortgage interest rate for a certain amount of time.

Low–Down Payment Feature: A feature of some mortgages, usually fixed-rate mortgages, that helps you buy a home with as little as a 3% down payment.

Margin: A percentage added to the index for an ARM to establish the interest rate on each adjustment date.

Market Value: The current value of your home based on what a purchaser would pay. Sometimes an appraisal is used to determine market value.

Mortgage: A loan using your home as collateral. In some states the term mortgage also describes the document you sign (to grant the lender a lien on your home). The term also may indicate the amount of money you borrow, with interest, to purchase your home. The amount of your mortgage is usually the purchase price of the home minus your down payment.

Mortgage Broker: An independent finance professional who specializes in bringing together borrowers and lenders to complete real estate mortgages.

Mortgage Insurance or Private Mortgage Insurance (MI or PMI): Insurance needed for mortgages with low down payments (usually less than 20% of the price of the home).

Mortgage Lender: The lender who provides funds for a mortgage. Lenders also manage the credit and financial information review, the property and the loan application process through closing.

Mortgage Rate: The cost or the interest rate you pay to borrow the money to buy your house.

Mutual Fund: A fund that pools the money of its investors to buy a variety of securities.

Glossary

Net Monthly Income: Your take-home pay after taxes. It is the amount of money that you actually receive in your paycheck.

Offer: A formal bid from the homebuyer to the home seller to purchase a home.

Open House: When the seller's real estate agent opens the seller's house to the public. You do not need a real estate agent to attend an open house.

Point: 1% of the amount of the mortgage. For example, if a loan is made for $50,000, one point equals $500.

Pre-Approval Letter: A letter from a mortgage lender indicating that you qualify for a mortgage of a specific amount. It also shows a home seller that you are a serious buyer.

Predatory Lending: Abusive lending practices that include making mortgage loans to people who do not have the income to repay them, or repeatedly refinancing loans, charging high points and fees each time and "packing" credit insurance onto a loan.

Pre-Qualification Letter: A letter from a mortgage lender that states that you are pre-qualified to buy a home, but it does not commit the lender to a particular mortgage amount.

Principal: The amount of money borrowed to buy your house, or the amount of the loan that has not yet been repaid to the lender. This does not include the interest you will pay to borrow that money. The principal balance (sometimes called the outstanding or unpaid principal balance) is the amount owed on the loan minus the amount you have repaid.

Private Mortgage Insurance (PMI): See Mortgage Insurance.

Property Appreciation: See Appreciation.

Radon: A toxic gas found in the soil beneath a house that can contribute to cancer and other illnesses.

Rate Cap: The limit on the amount an interest rate for an ARM can increase or decrease during an adjustment period.

Ratified Sales Contract: A contract that shows both you and the seller of the house have agreed to your offer. This offer may include sales contingencies, such as obtaining a mortgage of a certain type and rate, getting an acceptable inspection, making repairs and closing by a certain date.

Real Estate Professional: An individual who provides services for buying and selling homes. The seller pays the real estate professional a percentage of the home sale price. Unless you specifically have contracted with a buyer's agent, the real estate professional represents the interest of the seller. Real estate professionals may be able to refer you to local lenders or mortgage brokers, but they generally are not involved in the lending process.

Refinance: The process of getting a new mortgage and using all or some portion of the proceeds to pay off the original mortgage.

Replacement Cost: The cost to replace damaged personal property without a deduction for depreciation.

Securities: A financial form that shows that the holder owns shares of a company (stock) or has loaned money to a company or government organization (bond).

Title: The right to, and the ownership of, property. A title or deed sometimes is used as proof of ownership of land.

Title Insurance: Insurance that protects lenders and homeowners against legal problems with the title.

Truth-in-Lending Act (TILA): A federal law that requires disclosure of a truth-in-lending statement for consumer loans. The statement includes a summary of the total cost of credit, such as the APR and other specifics of the loan.

Underwriting: The process a lender uses to determine loan approval. It involves evaluating the property and the borrower's credit and ability to pay the mortgage.

Uniform Residential Loan Application: A standard mortgage application your lender will ask you to complete. The form requests your income, assets, liabilities and a description of the property you plan to buy, among other things.

Warranty: A written guarantee of the quality of a product and the promise to repair or replace defective parts free of charge.

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