06/02/2007

How to Buy a Home with Really Bad Credit

Going through a bankruptcy or a foreclosure is nasty business. If you have been through the process you know how it can ruin your credit score. You may wonder if you will ever be able to obtain financing again, especially if you will be able to get a home loan again. The good news is that you definitely can qualify for homeownership again; the bad news is that it will cost you.

Getting a mortgage loan after a foreclosure or bankruptcy is an expensive venture for some fairly obvious reasons. Mortgage lenders are in the business of evaluating risk. Anyone who has had a foreclosure is a huge risk because he has been unable to meet his mortgage responsibilities at least once before. Someone with a bankruptcy was unable to meet his overall financial obligations and left his creditors in the lurch. Mortgage lenders put a lot of money on the line by offering a borrower a loan. They have a much easier time lending to those with good credit histories, but many will lend to more risky borrowers. They will simply charge more in rates and fees to hedge against possible loss.

Consider the following comparison. Say a person with a credit score of 600 puts 10 percent down and gets an interest rate of 6 percent. A person with the same credit score and down payment and a history of foreclosure or bankruptcy might get a rate of 7.65 percent. On a $200,000 loan that means a difference of $220 each month in mortgage payments.

Now compare people with considerably worse credit, say a score of 500. If the person without the bankruptcy or foreclosure gets a rate of 6 percent, the one with the ‘troubled past’ might be charged as much as 9.85 percent. For a $200,000 home loan, the person with a former bankruptcy or foreclosure would pay about $530 more each month. And of course with even worse credit the interest rate would continue to increase.

Still, owning a home again may be worth the higher cost to you. Here are some things to remember: the longer you wait after a bankruptcy or foreclosure, the better the deal you will get. Bankruptcy will stay on your credit report for ten years, but even just waiting three or four years after filing will net you much better interest rates. Lenders like to borrowers to wait at least two years after filing for foreclosure before applying for a new home loan.

In the meantime, you can do your best to improve your credit score and improve your chances of having your loan application accepted. Start by getting into a stable job and stick with it for several years. This will offer some proof to mortgage lenders of your renewed financial responsibility. You can also be saving up for a sizeable down payment. Seeing that you are able to put a lot down at closing will also help put a lender’s mind at ease. Finally, obtain a major source of credit and use it wisely during your waiting period. Only make purchases that you can afford to pay off at the time anyway and then pay your credit bills early or on time. Over six months or more this can greatly improve your credit score.

The bottom line is that you can obtain mortgage financing again after financial crisis, just be prepared to either wait for a few years or be prepared to pay the higher costs.