

# Credit Scoring and Mortgage Modifications: *What Lenders Need to Know*

11-05-09

For the full webinar, including accompanying narration, please visit [www.vantagescore.com/research](http://www.vantagescore.com/research)

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## Questions to be answered today...

1. How do the variety of mortgage restructuring options impact homeowners' credit scores?
2. Are consumers at different credit quality levels impacted differently?
3. What drives a score to change?
4. How does the impact from voluntary restructuring options differ from involuntary options, such as foreclosure?
5. How can consumers, lenders and credit counselors work in the best interest of the consumer to rehabilitate scores?

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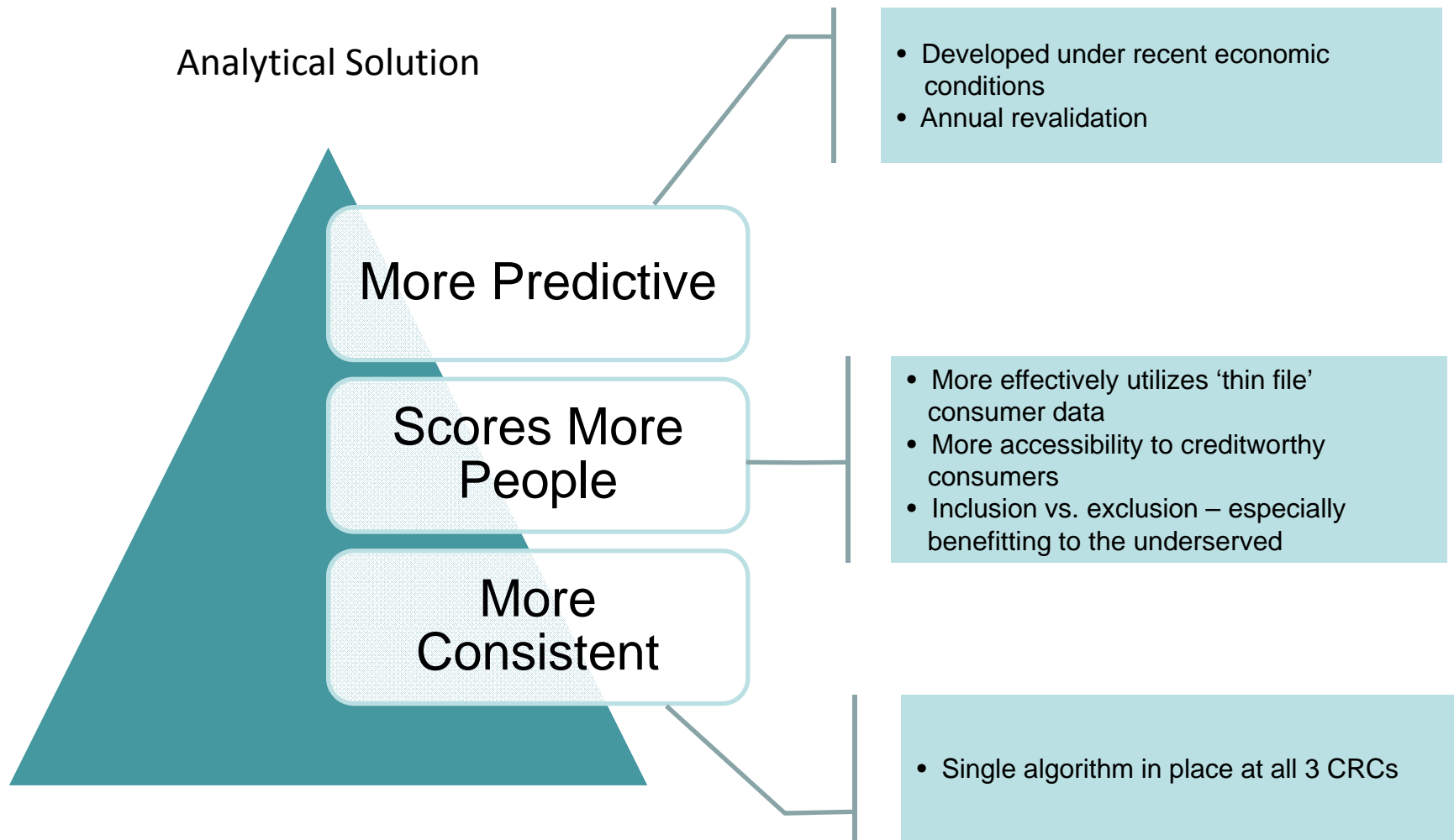
# Product Overview

## Quick Facts

- Generic consumer credit risk score
  - Likelihood of 90+ days past due
- Score range from 501-990
- Created by the 3 major Credit Reporting Companies:
  - Equifax, Experian, TransUnion
- Introduced in March 2006
  - Developed July - Dec 2005
  - Developed in direct response to market demand for a score that would be more predictive, score more people and be more consistent across all three CRCs.

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# VantageScore Goals



# Lenders now using VantageScore

VantageScore is used by numerous lenders, including:

- 3 of the top 10 mortgage originators
- 4 of the top 5, and 8 of the top 25 financial institutions
- 8 of the top 10 credit card issuers
- 7 of the Top 50 auto lenders

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# VantageScore in the Secondary Market

## Both Standard & Poors and Fitch Ratings accept loans based on VantageScore

- VantageScore is an acceptable option for **Standard & Poor's** clients to include in collateral characteristics when submitting portfolios of residential mortgage loans to Standard & Poor's for rating purposes.
- **Fitch Ratings** has fully incorporated VantageScore into ResiLogic 2.1, its flagship quantitative model that provides credit risk analysis at the individual loan and pool level for residential mortgage loans.

### According to Fitch:

*“VantageScore provides highly predictive evaluations of consumer creditworthiness.”*

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# STUDY APPROACH

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# Study Approach

- **CONSUMER PROFILES**

- Randomly select consumers from US population according to four profiles (approx 100,000 consumer per profile):
- For each population, the average VantageScore was calculated. This is the starting score for the profile

- **SCENARIO DESIGN**

- For each mortgage restructure scenario, the relevant trade line fields were edited to reflect the restructured loan

- **SCORE IMPACT**

- The consumer's VantageScore was recalculated, incorporating the information on the edited trade line. The difference between the starting score and the new score is shown

- **Note:** *Resulting consumer behavior is not known. Further studies will consider consumer behavior as a result of the restructure event.*

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Despite different eligibility criteria, government programs generally drive toward one of two restructure scenarios...

***...principal forgiveness or recapitalization of fees and past due amounts***

|   | Primary Residence                            | Mortgage Origination | Owned or guaranteed by Fannie Mae or Freddie Mac | Account Status                | Mortgage Amount               | Financial Hardship (e.g. Jump in interest rate, reduction in income, or unexpected medical bills) | Debt Burden   |
|---|--|----------------------|--|-------------------------------|-------------------------------|---|---|
| Making Home Affordable Programs/<br>Loan Modification | Yes  | Before Jan. 1, 2009  |  |                               | <=\$729,750 on first mortgage | Yes   | First mortgage payment (including tax and insurance) > 31% of current gross income                  |
| Fannie Mae & Freddie Mac                              | Yes, and must be one unit property           | Before Jan. 1 2008   | Yes  | 90dpd +                       |                               | Yes   | First mortgage payment (including tax and insurance) > 38% of current gross income                  |
| Hope for Homeowners                                   | Yes, and the owner doesn't own a second home | Before Jan. 1 2008   |  | Have made at least 6 payments |                               | Yes   | First mortgage payment (including tax and insurance) > 31% of current gross income as of March 2008 |

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# Loan restructures impact credit scores primarily through these mortgage trade line fields on the credit file

|   | Monthly Payment | Terms | Original Loan Amount / Credit Limit | Current Balance | Account Status | Comment/Status Codes(1) | Amount Past Due | Close Old/ Open New | First Mortgage | Second Mortgage |
|---|-----------------|-------|-------------------------------------|-----------------|----------------|-------------------------|-----------------|---------------------|----------------|-----------------|
| Forbearance                                       | X               |       |                                     |                 |                | BT/AC                   | X               | No                  | X              |                 |
| Making Home Affordable Programs/Loan Modification | X               | X     | X                                   | X               |                | AC                      |                 | Maybe               | X              |                 |
| Refinancing                                       | X               | X     | X                                   | X               |                | AC/AS/13                |                 | No                  | X              |                 |
| Fannie Mae & Freddie Mac                          | X               | X     | X                                   | X               |                | AC                      |                 | No                  | X              |                 |
| Hope for Home Owners                              | X               | X     | X                                   | X               |                | AS/13                   |                 | Yes                 | X              | X               |
| Short Sale  |                 |       |                                     | X               | X              | AU/13/61-65             |                 |                     | X              |                 |
| Foreclosure                                       |                 |       | X                                   | X               | X              | 65/89/94/BO             | X               |                     | X              |                 |
| Bankruptcy  |                 |       |                                     | X               | X              | Bankruptcy(2)           | X               |                     | X              | X               |

(1) The column represents reporting options which maybe reflected in the credit file that are used in the VantageScore algorithm.

(2) In Metro2, bankruptcy types are reflected in the 'Consumer Information Indicator'

# Polling Question #1

- For borrowers seeking assistance from you, what is the average level of mortgage delinquency at the time that the first meaningful contact is made?
  - Current
  - 30 days
  - 60 days
  - More than 60 days

# Consumer Profiles



**Group One: Clean credit**  
Consumers with current status on all trade lines. (May have prior 30 days delinquency)



**Group Two: First Mortgage Clean, other trades delinquent**  
Consumers who have kept their mortgage in a current status but are currently delinquent on other trade lines



**Group Three: First Mortgage Delinquent, other trades clean**  
Consumers who have become delinquent on their primary mortgage, but are current on all other trades



**Group Four: All Trades Delinquent**  
Consumers who are currently delinquent on all trade lines

# Consumer Profiles



| Average trade status                 | All trades clean | First mortgage clean,<br>other trades<br>delinquent | First mortgage<br>delinquent, other<br>trades clean | All Trades Delinquent |
|--------------------------------------|------------------|---|---|-----------------------|
| Total # of Open Trades               | 10.72            | 10.89   | 9.54  | 6.67                  |
| # of open trades 30+dpd <sup>1</sup> | 0.03             | 0.15  | 0.66  | 1.16                  |
| # of open trades 90+dpd              | 0.00             | 0.02  | 0.14  | 0.34                  |
| Total # of Open bankcard Trades      | 3.56             | 3.48  | 2.81  | 1.75                  |
| # of open bankcard trades 30+dpd     | 0.01             | 0.04  | 0.03  | 0.16                  |
| # of open bankcard trades 90+dpd     | 0.00             | 0.01  | 0.00  | 0.04                  |
| Total # of Open auto Trades          | 0.61             | 0.63  | 0.68  | 0.65                  |
| # of open auto trades 30+dpd         | 0.00             | 0.02  | 0.02  | 0.13                  |
| # of open auto trades 90+dpd         | 0.00             | 0.00  | 0.00  | 0.01                  |
| Total # of Open mortgage Trades      | 1.59             | 1.95  | 2.04  | 1.25                  |
| # of open mortgage trades 30+dpd     | 0.01             | 0.05  | 0.56  | 0.64                  |
| # of open mortgage trades 90+dpd     | 0.00             | 0.01  | 0.14  | 0.22                  |
| <b>VantageScore</b>                  | <b>862</b>       | <b>830</b>  | <b>722</b>  | <b>625</b>            |

<sup>1</sup>dpd – days past due

# Scenario Design

## Least Severe: Monthly payments modified

| Program           | Description  |
|-------------------|--|
| Forbearance       | Monthly Payment reduced or deferred for a short period; 3-6 months   |
| Loan Modification | Various ways of reducing payment through rate reduction, term extension, which leads to either principal forgiveness or recapitalization |

## More Severe: Monthly payments eliminated through derogatory events

| Program     | Description  |
|-------------|--|
| Short Sale  | Home is sold for less than principal still owed; bank agrees to accept this payment. |
| Foreclosure | Home sold at auction or bank takes possession  |
| Bankruptcy  | Home very likely surrendered or sold   |

# Scenario Design

## Least Severe: Monthly payments modified

| Program  | Scenario   |
|--|--|
| <p><b><u>Forbearance</u></b></p> <ol style="list-style-type: none"> <li>Interest Only Payment:</li> <li>Reduced Payment:</li> <li>Deferred Scenario:</li> </ol>                  | <ol style="list-style-type: none"> <li>Simulated by reducing the monthly payment amount to 25 percent of the original monthly payment amount.</li> <li>Structured as 50 percent of the original monthly payment.</li> <li>No payments are made and the tradeline contains a 'D' in the terms frequency field</li> </ol>  |
| <p><b><u>Loan Modification</u></b></p> <ol style="list-style-type: none"> <li>Existing loan remains and is overwritten</li> <li>Existing loan closed, new loan opened</li> </ol> | <p>Scenarios consider new and existing account structures with a range of loan amount adjustments.</p> <p><b>Principal forgiveness:</b> The current balance is reduced by 10 percent, 20 percent and 30 percent from the original current balance. Resulting monthly payment and term length are adjusted.</p> <p><b>Recapitalization:</b> The original loan amount is increased by 10 percent, 20 percent, and 30 percent to reflect the recapitalizations of fees and past due amount.</p> |

# Scenario Design

## More Severe: Monthly payments eliminated through derogatory events

| Program  | Scenario   |
|--|--|
| <ol style="list-style-type: none"><li>1. Short Sale</li><li>2. Foreclosure</li><li>3. Bankruptcy</li></ol> | Existing credit file reporting standards are applied to each consumer profile for all three derogatory events. |

# Score impact from various mortgage restructuring scenarios for consumers with a clean credit file

|                                    |  | All trades clean | All trades delinquent |   |
|------------------------------------|--|------------------|-----------------------|---|
| <b>VantageScore Starting Score</b> |  | <b>862</b>       | <b>625</b>            |   |
| <b>Forbearance</b>                 | Interest only  | 0                | 0                     | •No impact when payments are made on schedule.  |
|                                    | Reduced principal plus interest                                  | 0                | 0                     |   |
|                                    | Deferral   | -40 to -30       | 0 to 10               | •Account removed with deferral  |
| <b>Loan Modification</b>           | Forgive, no partial c/o, overwrite                               | 10 to 30         | 0 to 15               | <ul style="list-style-type: none"> <li>•Utilization reduction overall</li> <li>•Average account age reduced due to new loan</li> <li>•Higher Loan amount</li> <li>•Age reduced from new loan</li> <li>•Utilization reduction</li> </ul> |
|                                    | Forgive, no partial c/o, new loan                                | -14 to -20       | -2 to -5              |   |
|                                    | Recapitalization, overwrite                                      | 3 to 15          | 0 to 5                |   |
|                                    | Recap., new loan   | 2 to 10          | 0 to 3                |   |
|                                    | Recap. and forgive subord. loans<br>Recap. and highly delinquent | 3 to 10          | 12 to 18              |   |
| <b>Short Sale</b>                  |  | -130 to -120     | -25 to -15            | •Account highly delinquent  |
| <b>Foreclosure</b>                 | Foreclosure initiated  | -140 to -130     | -20 to -10            | •Derogatory status  |
|                                    | Foreclosure initiated, payment made                              | -125 to -115     | -10 to -5             |   |
| <b>Bankruptcy</b>                  | Filing only for mortgage trade line                              | -175 to -165     | -30 to -20            | •Derogatory status, public record   |
|                                    | All trade lines included in filing                               | -365 to -355     | -120 to -110          |   |

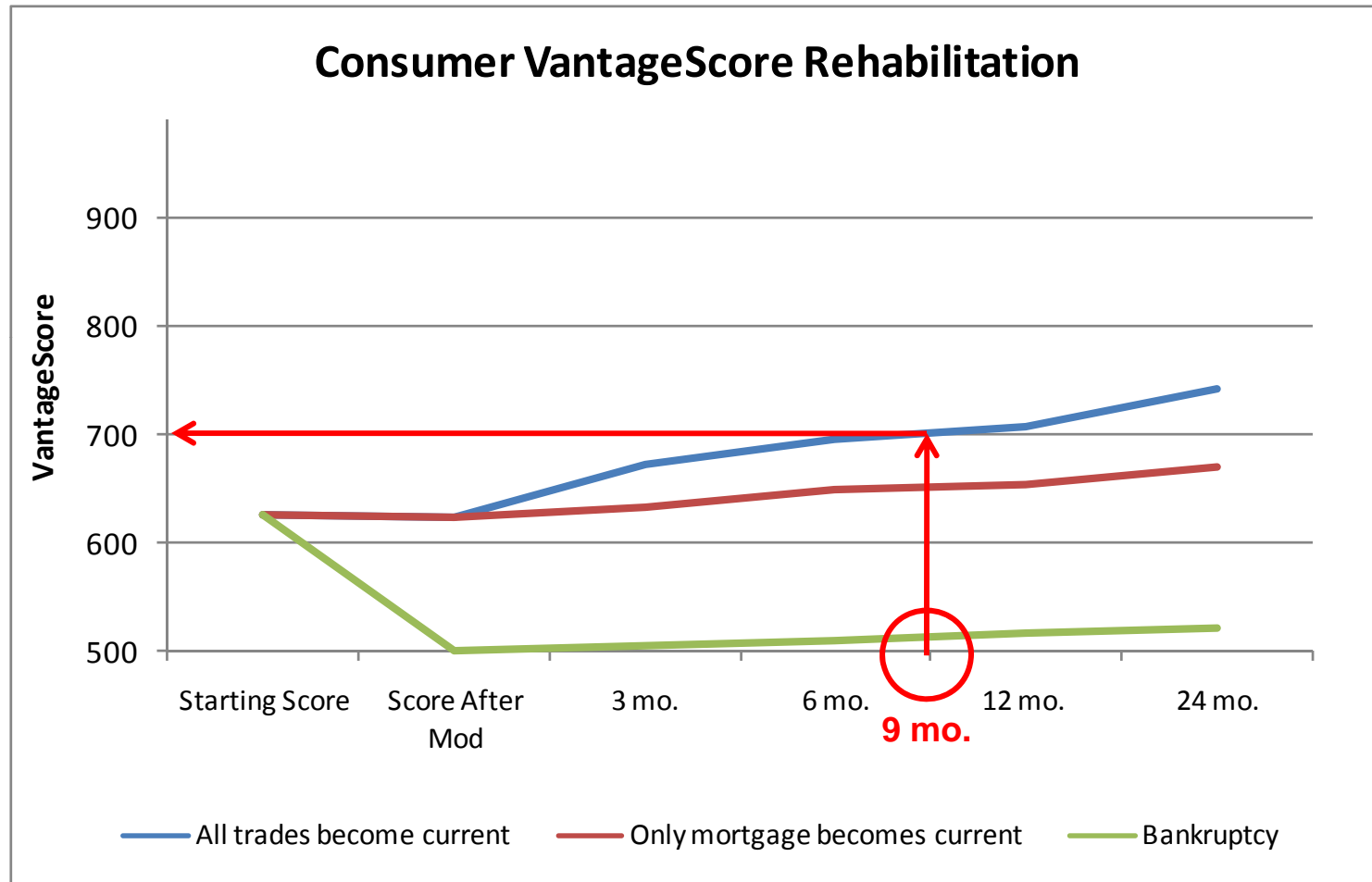
# Score impact from various mortgage modification scenarios for consumers with a clean credit file

|                                    |  | All trades clean | First mortgage clean, other trades delinquent | First mortgage delinquent, other trades clean | All trades delinquent |
|------------------------------------|--|------------------|---|---|-----------------------|
| <b>VantageScore Starting Score</b> |  | <b>862</b>       | <b>830</b>                                    | <b>722</b>                                    | <b>625</b>            |
| <b>Forbearance</b>                 | Interest only  | 0                | 0   | 0   | 0                     |
|                                    | Reduced principal plus interest                                  | 0                | 0   | 0   | 0                     |
|                                    | Deferral   | -40 to -30       | -35 to -25                                    | -10 to 0                                      | 0 to 10               |
| <b>Loan Modification</b>           | Forgive, no partial c/o, overwrite                               | 10 to 30         | 10 to 30                                      | 5 to 20                                       | 0 to 15               |
|                                    | Forgive, no partial c/o, new loan                                | -14 to -20       | -10 to -15                                    | -9 to -12                                     | -2 to -5              |
|                                    | Recapitalization, overwrite                                      | 3 to 15          | 2 to 10                                       | 2 to 7  | 0 to 5                |
|                                    | Recap., new loan   | 2 to 10          | 1 to 5  | 1 to 5  | 0 to 3                |
|                                    | Recap. and forgive subord. loans<br>Recap. and highly delinquent | 3 to 10          | 3 to 8  | 5 to 12                                       | 12 to 18              |
| <b>Short Sale</b>                  |  | -130 to -120     | -110 to -100                                  | -50 to -40                                    | -25 to -15            |
| <b>Foreclosure</b>                 | Foreclosure initiated  | -140 to -130     | -130 to -120                                  | -55 to -45                                    | -20 to -10            |
|                                    | Foreclosure initiated, payment made                              | -125 to -115     | -115 to -105                                  | -40 to -30                                    | -10 to -5             |
| <b>Bankruptcy</b>                  | Filing only for mortgage trade line                              | -175 to -165     | -160 to -150                                  | -70 to -60                                    | -30 to -20            |
|                                    | All trade lines included in filing                               | -365 to -355     | -330 to -320                                  | -220 to -210                                  | -120 to -110          |

# Polling Question – #2

- How would you rate the level of concern that consumers demonstrate regarding the impact on their credit score from loan restructuring programs that they are considering?
  - Very concerned
  - Somewhat concerned
  - Are not concerned at all, the monthly payment issues trump all
  - The question is never asked by a consumer

# Score Rehabilitation



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# What can a consumer do?

- **Work on issues before serious delinquency occurs.**
  - Consumers and lenders should proactively seek out loan modifications before the consumer experiences severe delinquency in their credit file. Late payments have a far greater impact on a credit score than loan modifications.
- **Through the modification, free-up sufficient cash to pay all debts on time.**
  - In order to rehabilitate the consumers score as quickly as possible, the restructured mortgage should provide sufficient cash availability to remain with the consumer so that any other delinquent debts can be brought to current status.
- **When possible, avoid bankruptcy.**
  - All chapters of bankruptcy filing have the greatest impact on a consumer score and will negatively affect the consumer score for a minimum of seven years due to the presence of a public record on the consumer file.

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# Conclusions around Loan Restructurings

- **Delinquency on a mortgage account has a far greater negative impact to credit scores than loan modifications**
- **Forbearance options**
  - Provided the consumer continues to make a timely payment, regardless of size, there is no immediate impact to their score.
- **Loan modifications generally cause a small change in score**
  - Exception to this is if a lender establishes a new loan as part of the restructure
- **Short sale, foreclosure and bankruptcy have the greatest impact to a score**
- **Consumer can rehabilitate their score in as little as 9 months**
  - Assuming they are able to bring all delinquent accounts to current status

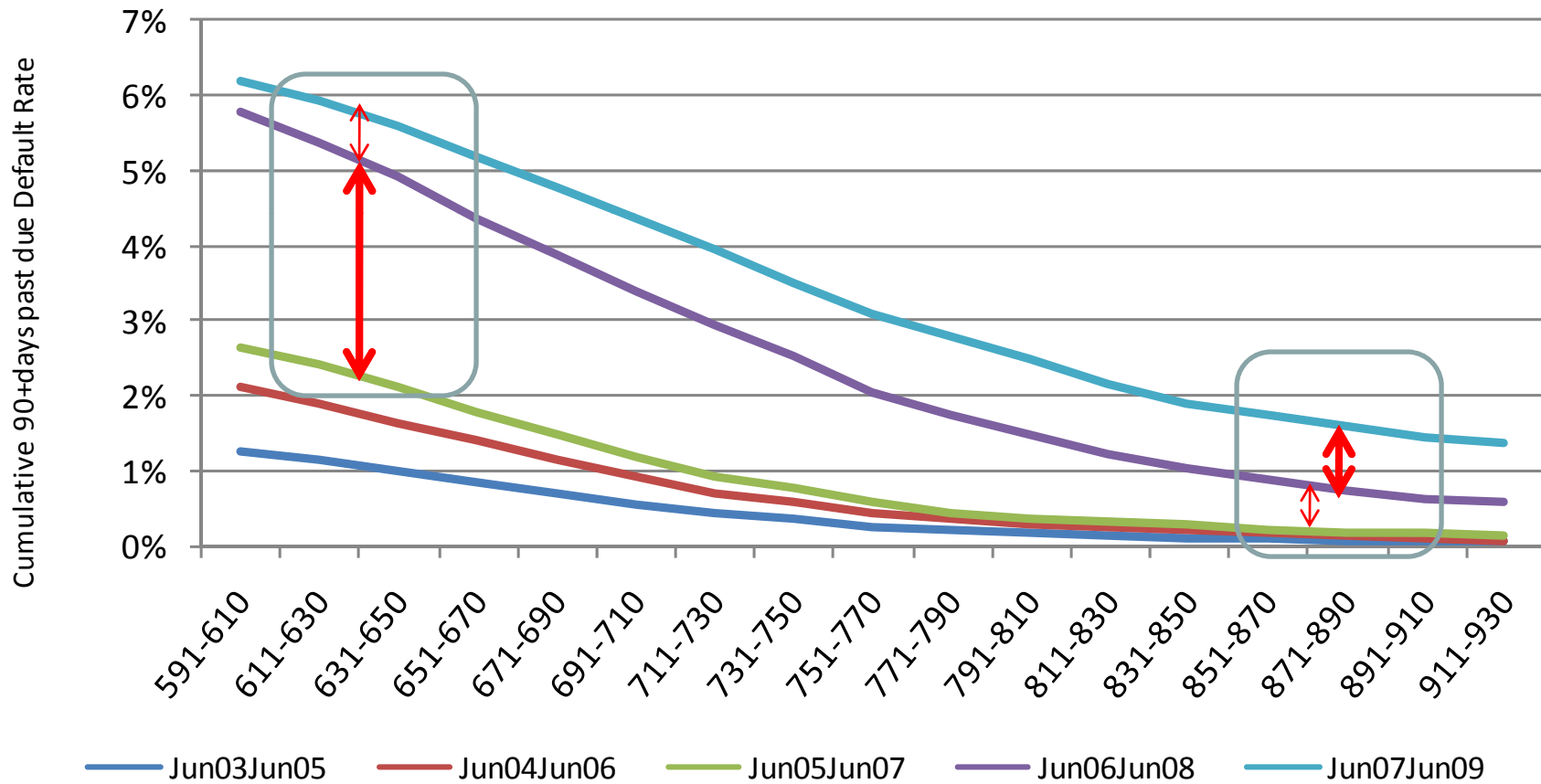
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# **UPDATED RISK PROFILES WITH LATEST DATA THROUGH JUNE 2009**

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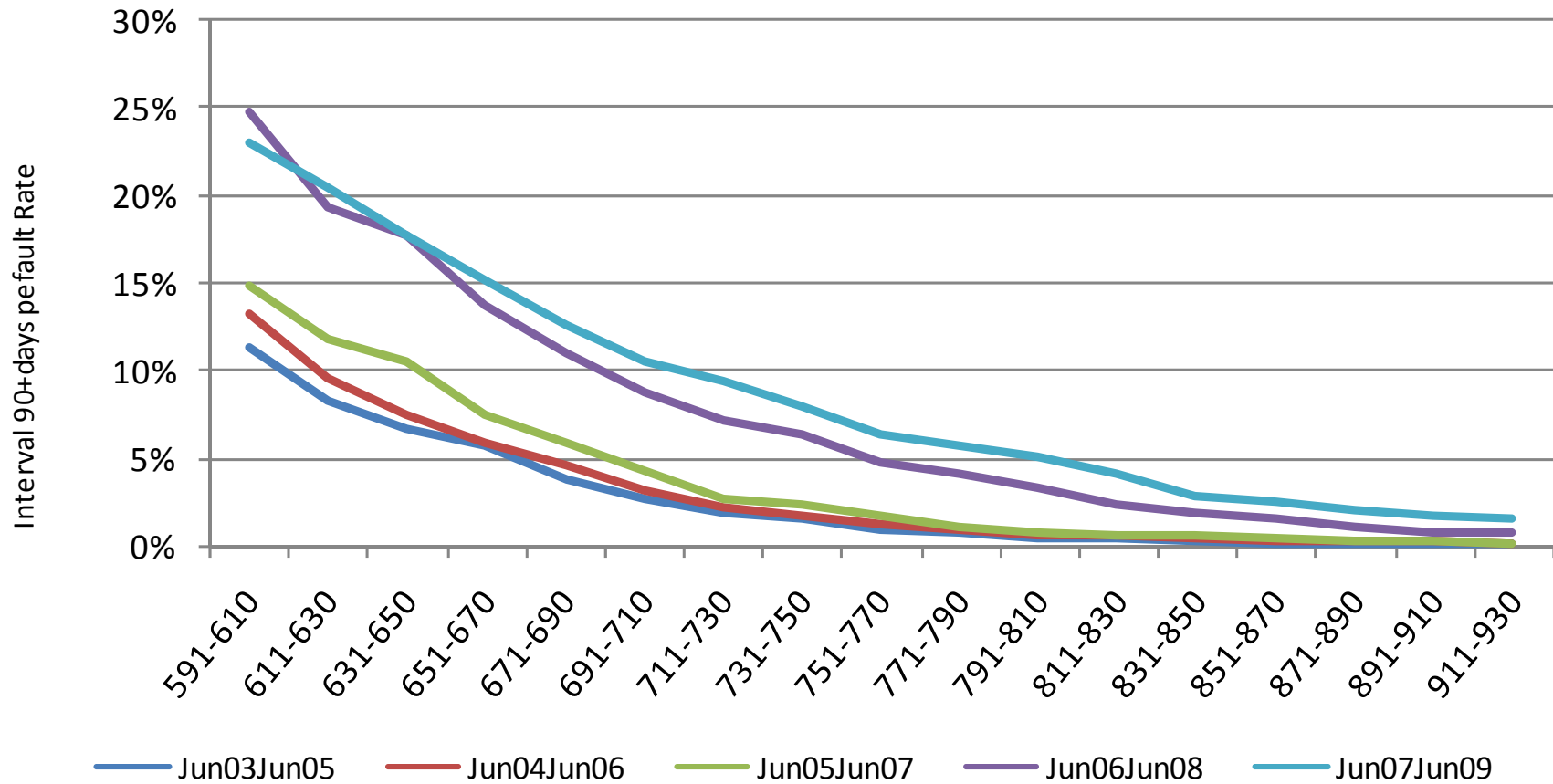
# Overall risk deterioration is slowing for real estate originations....while super-prime risk is increasing faster

New Accounts - 90+ Days Past Due Rates: Real Estate



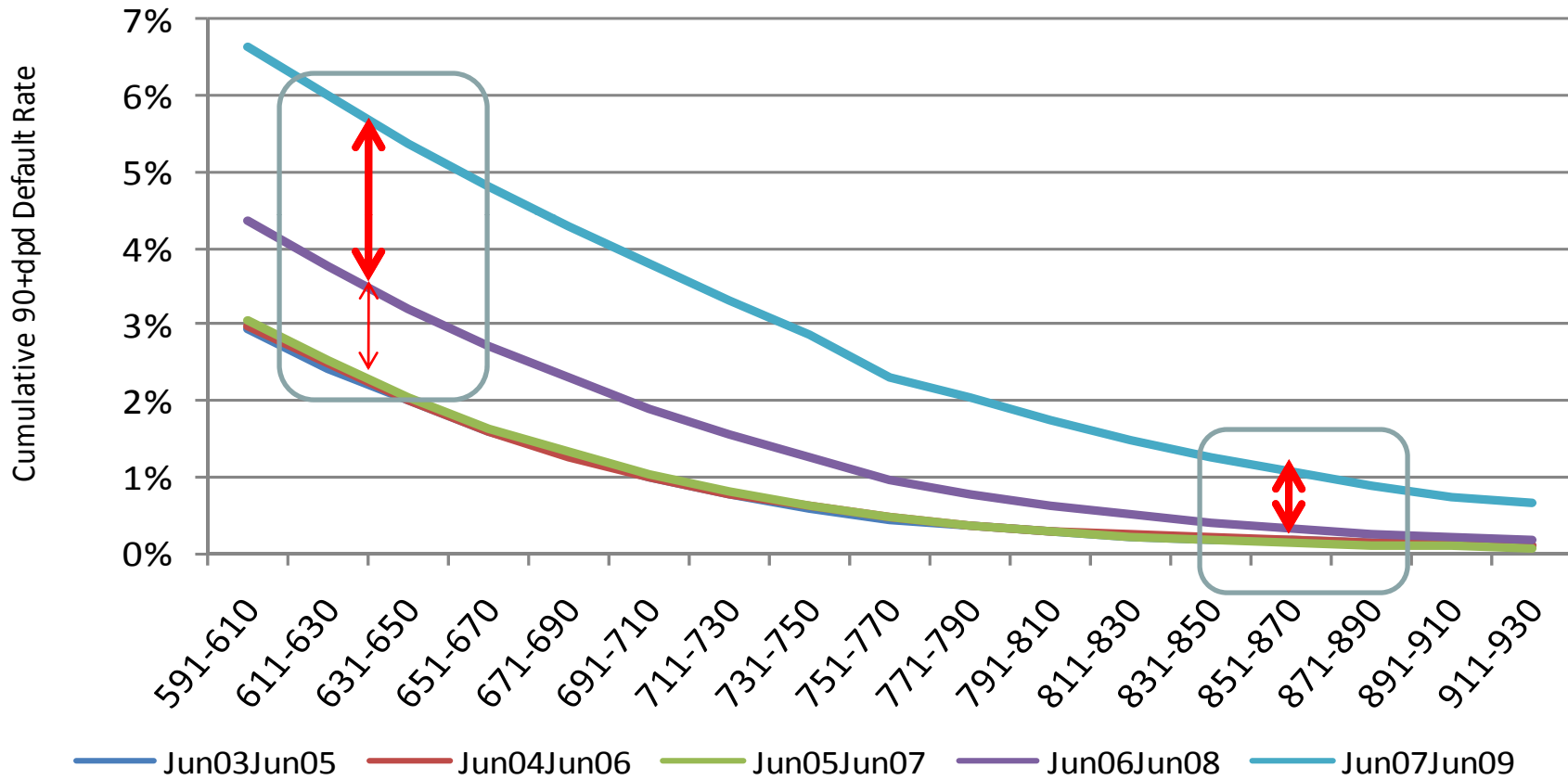
# Rank ordering remains strong

New Accounts - 90+ Days Past Due Rates: Real Estate



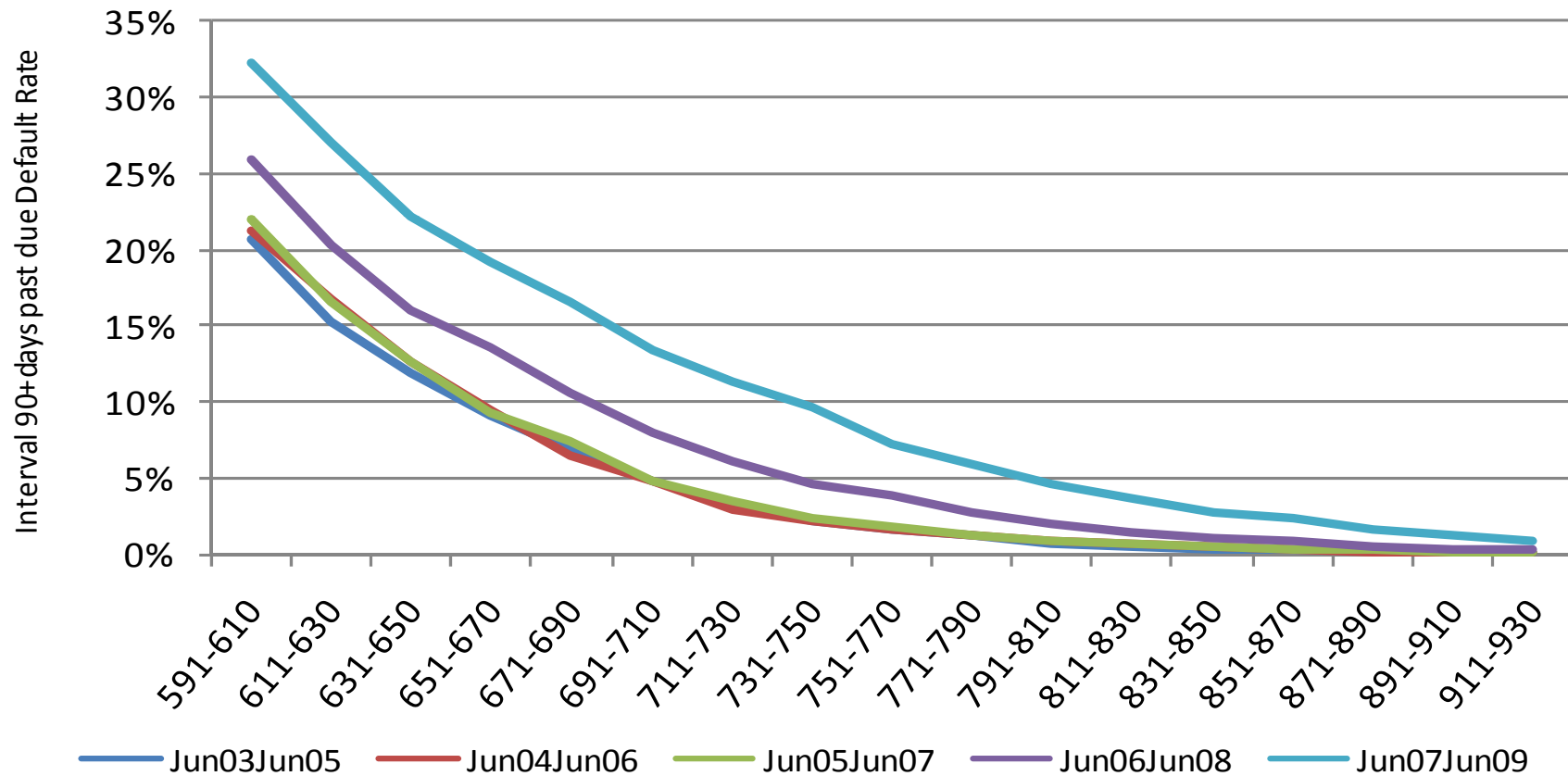
# Credit quality now deteriorating at greatest rate with existing accounts in real estate industry

Existing Accounts - 90+ Days Past Due Rates: Real Estate



Rank ordering is also strong with existing accounts – score remains robust

Existing Accounts - 90+ Days Past Due Rates: Real Estate



# Thank You

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