Guild Mortgage helps credit invisibles achieve homeownership with RIKI™

CASE STUDY

**FORMFREE**®

EXECUTIVE SUMMARY

Challenge

Approximately 50 million adults in the U.S. are credit invisible or credit unscorable. Because mortgage lenders use credit histories and scores to qualify applicants, it's difficult for these borrowers to qualify for a loan and, when they do qualify, they may be offered a higher interest rate or lower credit limit. These credit inequities impact minority and younger homebuyers especially, since they often are just starting out with credit, may prefer cash transactions, or can have several jobs with hard-to-document income.

Solution

San Diego-based Guild Mortgage Company (NYSE: GHLD) is one of America's largest mortgage lenders, having originated more than $19 billion in 2022 and employing more than 4,000 employees across 270 branches. As part of a companywide commitment to shrinking the nation's considerable racial homeownership gaps, in July 2022 Guild Mortgage introduced its Complete Rate program, powered by FormFree's Residual Income Knowledge Index® (RIKI®). Complete Rate allows Guild to evaluate applicants who don't have a credit score based on their complete financial picture — including their rent and utility payment histories and residual income. The evaluation can enable applicants to receive more favorable interest rates or loan fees than they would qualify for based on traditional credit scoring alone.

Benefits

- Fairer Evaluation of First-Time Homebuyers
- A Fast, Accurate Alternative to Manual Underwriting
- An Untapped Source of Pipeline Opportunity
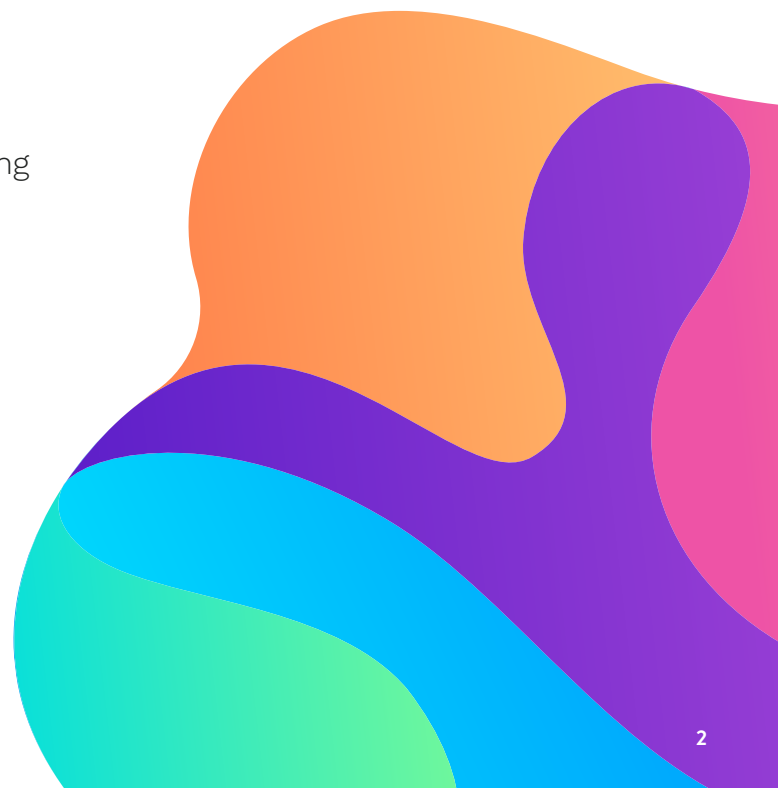
The Challenge

50 MILLION BORROWERS HAVE NO CREDIT SCORE

Guild Mortgage is a growth-oriented mortgage company that takes seriously its commitment to serving diverse clients and making a positive impact on diverse communities across the United States. As part of an enterprise-wide commitment to inclusive lending, Guild's highly trained loan professionals are experienced in originating affordable home loans including FHA, VA and USDA products as well as down payment assistance programs and other specialized loan programs. But when borrowers can't get approved for these programs due to their lack of credit history, it becomes harder for Guild to fulfill its commitment.

Manual processes exist for underwriting borrowers who lack a traditional credit history, but they are seldom used, accounting for an estimated 0.01% of all residential mortgage loans originated in the United States.

"Fannie Mae, Freddie Mac and HUD have had manual underwriting guidelines for non-traditional credit for decades, but they have close to zero usage," explains Guild Executive Vice President of Capital Markets David Battany. "The biggest reason is a lack of awareness. People assume that without a credit score, they shouldn't bother applying for a loan. Friends will say they have no chance. Realtors will tell them their credit isn't good enough. Even many mortgage experts are unaware of the manual underwriting option, so they don't offer it."

When credit invisibles do apply for home financing, approval is far from certain. The documentation required in lieu of credit history — which typically includes 12 months of cancelled rent checks, bank statements and utility bills — can take weeks to collect. The process is so arduous that borrowers often abandon their applications midstream.

It's no picnic for underwriters, either. By definition, manually underwritten loans are reviewed by human underwriters instead of automated underwriting systems. Scrutinizing hundreds of pages of scanned documents is both labor-intensive and susceptible to unintentional bias.

"Implied bias is a real risk," says Battany. "With a manually underwritten loan, the underwriter is looking for reasons to say no, not reasons to say yes, because they're personally accountable for signing off on the loan decision."

The few credit invisibles who overcome these obstacles and are extended an offer of credit are charged higher fees, a higher interest rate, or both. In fact, with traditional credit scoring models, a borrower with no credit score might be offered an interest rate a full percentage point or more over that of an otherwise comparable borrower with a credit score.

Just how many credit invisibles are left out of the homeownership pool by these obstacles? The Consumer Financial Protection Bureau (CFPB) estimates approximately 26 million adults (one out of 10) are "credit invisible," with no documented history of revolving credit cards, installment loans or home-equity lines of credit. Then there are 19 million more with a credit record but no current credit score because their credit history is "too thin" or "out-of-date."

The price of not having a credit score is disproportionately paid by minorities. According to the CFPB, 15% of Black and Hispanic people are credit invisible, compared to 9% of white and Asian people. An additional 13% of Black and 12% of Hispanic people are treated as unscorable, compared to just 7% of white people.

> **"There are 50 million Americans without credit scores. If even a small percentage of those — say, 5% or 10% — want to buy a house, that's still millions of people who could benefit from homeownership but can't qualify using traditional methods."**
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> **—David Battany, EVP of Capital Markets, Guild**

The Solution

COMPLETE RATE POWERED BY FORMFREE'S RIKI

Helping more credit-invisible consumers become homeowners requires lenders to examine them through a different lens. Guild sees each borrower's ability to repay as a three-legged stool: the more legs an applicant has firmly in place, the stronger a candidate they are for a mortgage loan.

The first leg is a pattern of timely payments on credit accounts — in other words, what traditional credit scores measure. "Credit scores are important, but I think our industry has become overly reliant on this one leg of the stool. And, of course, a stool with one leg won't stand up," Battany says. "You need the other two."

The second leg is a pattern of timely payments on non-credit accounts like rent, utilities and insurance. "If someone has been renting a house for 10 years and paying $2,000 a month, they can probably pay that same amount as a mortgage," he says. "That's a no-brainer."

The third leg is quantifying residual income, meaning how much money is left over after the monthly bills are paid — information that does not appear on credit reports and is not readily apparent from traditional underwriting evaluations. Residual income analysis takes into consideration more than just the W-2 wages that are assessed during the income verification stage of the underwriting process. "Let's say a loan applicant works five part-time jobs. If they're depositing money into one checking account, you can see the consistency of money coming in – even if it comes from five different sources — and see what remains after expenses are covered."

To put this three-legged stool philosophy into action, in July 2022 Guild Mortgage launched its Complete Rate program to provide a more inclusive path to homeownership. Instead of penalizing or declining applicants who lack traditional credit histories and scores, Complete Rate considers whether the other legs of the stool are in place and could support underwriting approval.

Powered by FormFree's Residual Income Knowledge Index™ (RIKI™), Complete Rate analyzes rent and utility payment history and average monthly residual income to evaluate the capacity of borrowers with no credit score to afford a home loan. With RIKI, there's no need for loan applicants to assemble months of paperwork; RIKI's proprietary analysis of bank transactions and balance data is retrieved directly from financial institutions in a matter of seconds with consumers' explicit consent. There is no cost to borrowers who opt into the assessment. And instead of wading through hundreds of pages of scanned documents, underwriters receive a single, 4-to-5 page report generated by FormFree that includes all the data points required under investors' manual underwriting guidelines.

> **If the RIKI report shows consistent rent payment history and good residual income history, the borrower may qualify to receive a lower interest rate, lower fees, or both.**

"In my view, we've taken what used to be an obstacle to homeownership and turned it into an opportunity," says Battany. "A credit score is powerful and predictive, but its weakness is that the borrower has to have had many revolving or installment accounts over many years. What's so powerful about RIKI is that it takes residual income into account to show if the applicant's income is trending in a positive or negative direction."

Benefits

FAIRER EVALUATION OF FIRST-TIME HOMEBUYERS

Before launching Complete Rate, Guild used historical loan production data to validate RIKI's efficacy at predicting default risk. Guild's analysis confirmed that RIKI predicts default risk at least as well as traditional credit scoring models — and when it comes to first-time homebuyers, RIKI outperforms traditional credit scoring models as a predictor of default.

A FAST, ACCURATE ALTERNATIVE TO MANUAL UNDERWRITING

By replacing arduous manual documentation with consumer-permissioned data sourced directly from banks, FormFree eliminates the paper chase that so often leads applicants to drop out of the loan process. A streamlined report saves underwriters hours of review and eliminates the risk of making an approval decision based on fraudulent documentation.

AN UNTAPPED SOURCE OF PIPELINE OPPORTUNITY

Most lenders consider the credit indivisibles in their database unmarketable — but not Guild. Armed with RIKI, Guild can confidently extend credit to historically un-served and underserved groups including consumers with limited to no credit history, minority and low-to-moderate income consumers, and workers with non-traditional employment that doesn't offer a W-2.

"Today our Complete Rate program focuses on helping those without credit history qualify for a better interest rate or lower fees, but we are also evaluating opportunities to use RIKI to serve individuals with thin credit files or with credit scores below 620. Another trend we are tracking is a growing need to serve borrowers who rely on multiple sources of non-W-2 income. RIKI is the ideal tool for understanding the debt capacity of these earners."

What's Next

Guild is proud to be on the forefront of the industry's adoption of alternative credit data. But, Battany says, the work is just beginning.

"We learned a great deal in the process of developing the Complete Rate program. We're satisfied that RIKI is a strong predictor of default risk, and we have validated that all the data required for manual underwriting can be packaged for AUS ingestion in a matter of minutes. Now it's a matter of policy catching up to progress," said Battany. "Our industry has an opportunity to help people who have been sidelined from homeownership for decades, including minorities who are almost twice as likely not to have a credit score — but it will take all of us working together, from the GSEs and like-minded lenders to housing counselors and policymakers."

To learn more, visit **https://riki.formfree.com**.

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About Guild Mortgage

Founded in 1960 when the modern U.S. mortgage industry was just forming, Guild Mortgage Company is a nationally recognized independent mortgage lender providing residential mortgage products and local in-house origination and servicing. Guild's collaborative culture and commitment to diversity and inclusion enable it to deliver a personalized experience for each customer. With more than 4,000 employees and over 250 retail branches, Guild has relationships with credit unions, community banks, and other financial institutions and services loans in 49 states and the District of Columbia. Guild's highly trained loan professionals are experienced in government-sponsored programs such as FHA, VA, USDA, down payment assistance programs and other specialized loan programs. Guild Mortgage Company is a wholly owned subsidiary of Guild Holdings Company, whose shares of Class A common stock trade on the New York Stock Exchange under the symbol GHLD.

About FormFree

FormFree helps lenders understand credit risk like never before with its patented Passport® product, which opens doors to more inclusive credit decisioning by revealing each customer's true ability to pay (ATP®), and patent-pending Residual Knowledge Income Index™ (RIKI™), an innovative method for evaluating consumer creditworthiness based on residual income analysis.