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Credit Score Truths and Myths

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Your credit score is the single biggest factor in getting a new home loa! If your score is above 720, you can possibly qualify for a $1 million home with very little money down. If your score is below 500 and you have $1 million in the bank, you may have trouble qualifying for this exact same home. Your interest rate will certainly be different.

Credit scores are central to the loan process. Nearly every lender uses them.?The better your credit, the lower the risk to the bank, the lower your interest rate.

Most lenders use your FICO score to determine whether or not you qualify for a home. It's such an important issue that you and your clients?should understand the basics of the credit reporting system and the many myths surrounding it.

Credit scores give lenders a fast, objective and impartial snapshot of a person's credit risk based on their credit history.

That's why lenders use FICO credit scores when making credit decisions. The higher the individual's score, the lower the risk to lenders when extending new credit to that person. Its fast, easy, and, usually, effective.

ABOUT YOUR FICO SCORE Think about your credit report as a story about your financial life, as told through your credit history.?This has nothing to do with you personally. Everything is there from the first credit card you got out of high school to your cell phones to your most recent mortgage. It all has a very telling?payment history. Some of it is good and some of it maybe not-so-good.?Regardless, it tells a lender what he needs to know about you.?It tells the lender how committed you have?been, historically, to paying your bills, both big and small,?on time.
It simply tells us how risky it is?to loan you money.
A FICO score is a credit score developed by Fair Isaac & Co. Credit scoring.?It is a method of determining the likelihood that credit users will pay their bills.?It helps lenders determine?the "risk" in?granting you a loan.
This method has become widely accepted by lenders as a reliable means of credit evaluation.?A credit score attempts to condense a borrower's credit history into a single number.?Fair, Isaac & Co. and the credit bureaus do not reveal how these scores are computed and?The Federal Trade Commission has ruled this to be acceptable.
Credit scores are calculated by using scoring models and mathematical tables that assign points for different pieces of information which best predict future credit performance.?It basically gives us a risk rating today of how likely you are, compared to the rest of the people in the U.S., of paying your bills tomorrow.
Credit scores measure the likelihood of default, so credit scores are generated using factors that have been found to predict credit risk. These factors are not weighted evenly and several minor instances may indicate a higher risk than one major, but isolated, credit problem.
There are five main categories of credit information which impact your credit score:
1. Late payments, delinquencies, bankruptcies: Past inability to pay on time will hurt your chances of getting credit in the future. More recent problems will be counted more heavily than those in the past.
2. Outstanding debt: The more debt one has, the greater the risk that he or she will not be able to keep up with the payments
3. Length of credit history: With a short track record it is harder for a lender to assess creditworthiness
4. New applications for credit (inquiries): Frequent credit checks by lenders may indicate that a borrower is looking to increase his or her amount of debt.
5. Types of credit in use: Some types of credit, including credit cards, provide you with a credit line greater than the amount you have already borrowed. The more credit available, the greater the risk to the lender since a borrower can

easily increase their outstanding debt.

There are really three FICO scores computed by data provided by each of the three major?bureaus??Experian, Trans Union and Equifax.

Most lenders use the middle of these three scores.?For example, if Experian gave you a 689, Trans Union 704, and Equifax 696, we would throw out the top score (Trans Union 704), throw out the bottom score (Experian 689) and use the middle score of 696 from Equifax.

Your FICO score for the purposes of our loan would be 696.

The bureaus don?t all share the same data and thus all have different scores?. One bureau may list more accounts for you than another, for example, and the differences (in types of accounts, payment histories, credit limits and balances) will be reflected in the score that bureau computes for you.

Because of those differences, it makes sense to pull and examine your credit reports from all three bureaus before you apply for a mortgage.?Fixing errors in all three reports before you shop for a loan is smart.?We will discuss how to get a copy of your credit report and how to fix it later in this newsletter.

Here are the most frequently asked questions about credit reports:

WHAT IS A GOOD CREDIT SCORE?

Credit scores generally range from?the mid-300's?to a perfect score of 850.

The following will give you a general idea of what your score tells lenders, but remember there are no set rules.?Different products and lenders use different guidelines for what is an acceptable score.

Also, there will usually be differences in the scores calculated by each of the three credit bureaus.?As stated,?lenders will often use the middle of your three scores.

720+ = Excellent credit.?You should have no problems as most loan programs will be available to you.

680 - 719 = Good credit.?You should have?few problems depending on what product you seek.

620 - 679 = Lender has to take a closer look at your file but should be able to qualify you for a loan.?Some products?may not be available.

570 - 619 = Higher risk; you will not be eligible for the best rates and products.?Products will be limited.

Below 570?= Very high risk.?Products will be limited and other factors will need to be considered.

The average person in the U.S. has a credit score?around 675.?As?you can see on the list above, the average?borrower's file needs a?"closer look"?and?is not?a "slam-dunk."

HOW DOES?MY SCORE AFFECT MY INTEREST RATE?

The better your score, the lower the risk to the lender, the lower your interest rate.

Let's say that John Doe is buying a new house for $300,000.?He is employed, can?document his income through his tax returns,?and has enough funds verified in the bank to put 20% down on the purchase of his new?$300,000 home.?He wants a 30-year fixed mortgage.

Below you will find an example of how?Mr. Doe's interest rate?may fluctuate based on his credit score.

MID-FICO:?INTEREST RATE:

720+?5.60%

680-719?5.80%

620-679?6.50%

570-619?7.25%

500-569?9.00%+

This is a primary example of why when you ask your lender, "what is the rate today?" the answer is not simple unless they know the credit score and financial profile of the borrower.?Rates change based primarily on credit scores, use (owner-occupied vs. investment), income documentation, down payment,?and?availability?of funds.

WHAT FACTORS MAKE UP MY SCORE?

Some of the factors considered in credit scores:

Past problems:

? Delinquency

? Recent or serious derogatory public record or collection

? Past due balances

Limited information:

? Account payment or credit history not long enough

? Lack of recent information on accounts

? Insufficient number of satisfactory accounts
? Date of last credit too recent
? Too few or no recent balances on revolving accounts (e.g. credit cards)
Factors correlated with higher risk:
? Excessive amount owed on accounts
? Proportion of loan balances on installment accounts
? Too many new or existing accounts
? Too many recent credit checks
? Proportion of revolving balances to revolving credit limits is too high (e.g. credit card balance vs. limit)
Factors not considered in credit scores
? Age
? Race
? Gender
? Religion
? National origin
? Receipt of public assistance
? Inquiries made by companies for promotional or account monitoring purposes?(credit card companies, where you have accounts,?often run your credit to make sure your situation?has not dramatically changed)

DOES MY CREDIT SCORE?GO DOWN?EVERY TIME IT IS CHECKED?

Credit inquiries are a negative factor in determining credit scores. That?s because statistical studies show that multiple inquiries are associated with high risk of default. Distressed borrowers often contact many lenders hoping to find one who will approve them.

However, multiple inquiries can also result from applicants shopping for the best deal.?The credit bureaus understand this and try not penalize you for it.

Credit scorers?usually ignore inquiries, from a same industry,?that occur within 30 days of a score date.?Suppose I shopped a lender on May 30, for example, and the lender has my credit scored that day.?Even if I had shopped 5 other lenders in May and they had all checked my credit, none of those inquiries should affect my credit score on May 30.

Now, if you are also shopping for a new car, a new big screen TV, and applying for new credit cards during this same period, yes, that will?create negativity on your credit report.

Remember, this score is assessing the "risk" in giving you a new loan.?If you are contacting may different types of lenders for many different products, you are giving the appearance of extending your credit our further and that makes you more risky.

You?may also?damage your credit if you spread your shopping over many months.?Circumstances can cause a consumer to shop, drop out of the market, and return later when conditions are more favorable. You minimize the adverse effect by concentrating each shopping episode to as short a window as possible.

WILL CLOSING SOME OF MY ACCOUNTS HELP MY CREDIT SCORE?

Usually not.?Closing accounts?will not usually help your credit score, and may?actually hurt it.

Too many open accounts can hurt your score.?But once you?ve opened the accounts, you?ve done the damage. You can?t repair it by shutting the account, and you may actually make things worse.

The credit score looks at the difference between your available credit and what you?re using.?Shut down accounts, and your total available credit shrinks, making your balances loom larger, which typically hurts your score.

The score also tracks the length of your credit history. Shutting older accounts can also make your credit history look younger than it actually is, which can hurt your score.

Rather than closing accounts, pay down your credit card debt. That?s something that actually can and usually will improve your score.

If you must close accounts, transfer the balances from newer accounts to older ones and close the ones you have opened most recently.

HOW OFTEN DOES MY SCORE CHANGE?

Your credit report is continually updated with new information from your creditors.

The FICO score is calculated based on the latest snapshot of information contained in your credit report at the time the score is requested.?Your FICO score from a month ago is probably not the same score a lender would

get from the consumer reporting agency today.?Fluctuations of a few points from month to month are quite common.
IF MY CREDIT REPORT HAS SOMETHING WRONG ON IT, WHAT CAN I DO?
As opposed to most lenders who offer you opinions on this subject, I have done this exercise myself.
The first thing you must do is get a copy of your report.?I strongly suggest for the best and quickest response, you get a copy of your report from each of the three major bureaus.?The easiest and most effective way is to request this online.
Each of the bureaus will charge you a small fee?for your credit report?but you will get online access and better response times.
If you want to save time and money,?you can?visit?a website called www.myfico.com.?The site is owned by Fair, Isaac and Co.?In my opinion, it has the best tools for credit repair.?Be sure to?purchase their top package, which?is $48 at the time of this writing.?Texans can also get a free copy once per year at www.annualcreditreport.com.Both will give you a copy of all three major bureau?reports and also have ready-to-use, simple?online tools for credit repair like pre-written letters for dispute.
Here is the contact information for each:
Equifax
P.O. Box 740241
Atlanta, GA 30374
1-800-685-1111
http://www.equifax.com
Experian
P.O. Box 2104
Allen, Texas 75013-2104
1-888-EXPERIAN (1-888-397-3742)
http://www.experian.com
Trans Union
Consumer Disclosure Center
2 Baldwin Place
P.O. Box 1000
Chester, PA 19022
1-800-888-4213
http://www.transunion.com
Once you get your report, review it very carefully.?If there is an item on your credit report that you feel is inaccurate, and there likely will be, you should?challenge it.?Details on how to challenge will be sent you with your credit report.?The credit bureau is required to begin investigating the issue within 5 business days.?They are held to this action by an Act?of Congress and they will move fast.
They will contact the creditor on your behalf.?You can also contact the creditor yourself?but be prepared?to experience complete and utter frustration at its highest level.?Do not only contact the creditor.?The bureau is absolutely your best bet!
Within about 30 days, you should have an answer to your complaint.?If, at that time, the original grantor of credit has not responded to the disputed item, it will be removed from your credit report.?However, if the creditor responds and challenges your claims, you may have more work to do.
I am amazed at how many people have never seen their credit report until they actually buy their home.?There is rarely enough time in the period between the day you make an offer until the day you close to correct your credit report in such a manner that will make a substantial difference in your score.
Planning ahead can result in cleaning your report,?raising your score, and saving you $10,000's?in interest through the years.
I COMPLETELY PAID OFF ALL OF MY DEBT, WHY IS IT STILL ON MY CREDIT REPORT?
A credit report shows?your entire credit history, including paid off debts. Judgments and liens will remain in your history for up to?10 years. A bankruptcy may stay on your credit report for 10 years as well.?Just because you?paid it off, does not mean it did not exist.
Like I stated earlier, if you look at this report as the financial story of your life, this existed and although it is now paid, it tells a story about a time when the debt, for whatever reason,?went without being paid.

If you were late on?your MasterCard?five times in six years, just because you paid it off does not mean it is now a positive reflection on your credit report vs. the negative reflection it was before, which some people automatically assume.?It simply shows that you were late at times but then paid it off.?Don't expect a huge increase in your score as a result of this action.?Keep in mind, the score is based on your credit history, not just how you are today.

HOW CAN I IMPROVE MY SCORE?

? Pay your bills on time.?Late payments and collections can have a serious impact on your score.

? Keep balances low on credit cards.?Do not "max-out" your cards.?Most experts say keeping your balances below 60% is the most effective.?For example, if you have a Visa with a limit of $2000, it is best to keep the balance at $1200 or less.

? Limit your credit accounts to what you really need. Accounts that are no longer needed should be formally cancelled since zero balance accounts can still count against you.?However, remember, if you are closing accounts, transfer the balances to the oldest accounts and cancel the newer ones.

? Do not apply for credit frequently. Having a large number of inquiries on your credit report can worsen your score.

? Check that your credit report information is accurate.

? Be conservative in applying for credit and make sure that your credit is only checked when necessary.

? If you have limited credit, obtain additional credit.?Not having sufficient credit can negatively impact your score.

HOW LONG DOES IT TAKE TO SEE MY SCORES GO UP?

I have seen pro-active people, who aggressively corrected their reports, raise their scores as much as 50 to 75 points in less than 60 days, but I would not count on that.?Your credit score is based on your history and that cannot be corrected overnight.?Everyday people tell me "my score is 600 but it will be 700 after I make all of the corrections."

That is not very likely but it is important that you review your report, correct it, and then, if you really care about?keeping it clean, pay your bills on time, don't over extend yourself and?don't max your cards out.

I know of people who are?only a few years out of bankruptcy and have gotten their scores up?in the high-600's.?If you stay on top of it, and work at it, no matter where you are today, you can have great credit.

Have a great and prosperous week!

Christina Whipple
http://www.ChristinaWhipple.com

Posted by Christina Whipple in San Antonio Real Estate at 11:16

This article is so educational, very thorough, yet stated so succintly. May I have your permission to link to it from my own blog site so my readers can see it in its entirety?

I see that I may *trackback*, but there seems no explanation as to how or what that is.

Super duper job on your blog and website, I feel it is the very best real estate one I've seen so far. Anonymous on Mar 18 2006, 06:10

This is the best 'free' article on credit scores I've read so far. Everytime I wanted information on how to read my credit score, I'd have to pay or buy a book or something. This was very educational and it answered all of my questions. Thanks. Anonymous on Jul 12 2006, 00:45