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Mortgage Matters – Credit Scoring 101

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Today, the most important aspect of qualifying for a home loan is your credit score. While your available income, assets, and employment will always play a major role in the approval process, in these days of increasing personal debt, your credit score truly makes the difference in what kind of loan you can qualify for. Following are some essential things you need to know about your score and how you can empower yourself to raise your score.

The Three Credit Bureaus

The three credit bureaus are Experian (produces your FICO score), TransUnion (produces your EMPRICA score), and Equifax (produces your BEACON score). Each of these bureaus utilizes a risk-based scoring model to determine the likelihood of you repaying your debt in full and on time.

How High or Low Can the Score Go?

Credit scores range from 300 – 850. However, when it comes to qualifying for a loan you can use the following tier structure:

850 –720	Outstanding
719 –680	Very good
679 –621	Good
620 –501	Caution
500 –below	Needs work

When you visit a lender and they pull your credit, they should be receiving a "tri-merge"credit report which has the most up-to-date information and scores from all three bureaus. Another important thing to know is that the score that all lenders should be using is your middle score. This is done to protect the potential borrower from obtaining a loan based on incomplete information. For example, if your scores are 701, 683, and 619, having the lender use the 683 score will give you better pricing and loan options. If that lender only had the 619 score, then you will get worse case pricing. On a local level, according to Experian's www.nationalscoreindex.com website, the average credit score for the greater Manatee and Sarasota area is 671. While this score is considered healthy enough for most people to qualify for a good number of loan programs, I still highly recommend making the necessary adjustments to boost your score above 680 and reach for the 720 and above range. Why is this so important?

The Score is Up...and it's GOOD!

Even the difference between a 718 score versus a 721 score is great when it comes to comparing what type of loan you can obtain. For example, a homebuyer looking to purchase a second home in Lakewood Ranch can easily qualify for a $600,000 interest-only jumbo loan with a premium interest rate if their score is 721. However, if you are a homebuyer with a 718 score, you may only qualify for that second home with a non-interest only jumbo mortgage and a non-premium interest rate.

Breaking the Score Down

Payment history impacts your score by 35 percent.

Remember, the credit scoring model is based on risk. From a lender's point of view, the person with that 718 is still more likely to make a late payment, or even have their loan foreclosed on. Therefore, it is crucial to make your mortgage and other monthly payments on time since a late payment will significantly decrease your score.

Debt ratio or outstanding credit balance impacts your score by 30 percent.

To determine your debt ratio, divide your outstanding balance to your available credit.

Keeping your debt ratios below 50 percent is preferable. Keeping your debt ratio below 30 percent has an even a greater effect on increasing your score. Having a ratio over 50 percent will lower your score since you are close to maxing out your credit line and more likely to make a late payment.

Length of credit history impacts your score by 15 percent.

Keeping your credit lines open is very important. The credit scoring model rewards good credit history, so closing your old accounts is not a good idea. Remember, opening new credit lines will decrease your score initially, but once you start making regular payments and keep the ratio low on each new line, your score will increase.

Credit types have a 10 percent impact on your score.

A good mix of mortgage and auto loans along with credit cards is viewed as favorable. If you have only credit cards, that is ok, but make sure to keep the ratios as low as you can.

Inquiries have a 10 percent impact on your score.

Here's the scoop on inquiries. When you shop for a mortgage loan within a 14-day time span, all three credit bureaus will count that as one inquiry. This will, in no way, impact your score significantly. However, if you shop for a mortgage or auto loan for longer than 14 days, each time your credit profile is pulled, it will count as one additional inquiry. This 14-day window does not apply to general and specialty store credit cards, equity loans, or home equity lines of credit. As these inquiries add up, the scoring model begins to add risk and therefore your score will drop.

How to Get Your Credit Report for Free

Even if you aren't shopping for a loan, the best thing anyone can do is obtain their credit report. Get your free credit report from www.annualcreditreport.com. While the free versions will not show you your score, for a small fee, you can get your score from all three bureaus.

Jonathan Santiago is a mortgage advisor with American Home Mortgage. He lives and works in Lakewood Ranch and specializes in mortgage planning. For more information on credit scores, or for a free "Know the Score" packet and CD, he can be reached at jonathan.santiago @americanhm.com or 941-907-2911.