

Your Credit Score

What It Means to You as a Prospective Home Buyer

Introduction

The subject of credit scoring has become an increasingly hot topic, and for good reason. For many years, the general public only associated the concept of credit scoring with the need to purchase high-ticket items such as a new car or a home. Today, credit scoring goes much further. Your credit score can affect your ability to get a good rate on commodities such as car insurance, cell phones, or even determine whether or not you get the job that you want.

Indeed, the financial snapshot provided by the credit score has also become a gauge for many employers, especially those who seek to place employees in a position of financial responsibility.

The History of Credit Scoring

The credit score system used today has evolved since the 1960s. It was originally designed to provide lenders with financial profiles on consumers who wished to borrow money. The lenders' biggest concern was whether or not an individual had the ability to repay a loan, and establish what percentage of risk might be involved.

Congress passed the Fair Credit Reporting Act in 1971 to establish guidelines for fair practices in regard to the use of credit scoring. This law was designed to promote accuracy in reporting and protect the privacy of consumers. In light of the increased use of credit scoring and a growing fear of identity theft, recent legislation has been passed to further protect Americans and improve consumer awareness.

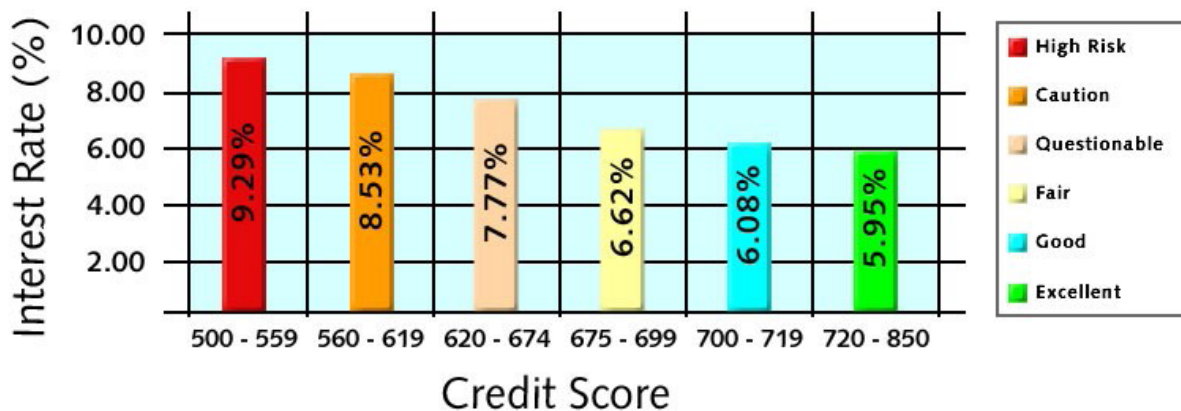
The Fair and Accurate Credit Transactions Act of 2003 (sometimes referred to as The FACT ACT or FACTA) was signed by President George W. Bush on December 4, 2003. This amended the Fair Credit Reporting Act, enabling each American to obtain one free credit report every 12 months from each of the three main credit reporting agencies (CRAs); Equifax, Experian and TransUnion. Those bureaus have created a central web site, www.annualcreditreport.com, to accommodate Americans who wish to obtain copies of their credit report.

Why Your Credit Score is So Important

The credit scoring model seeks to quantify the likelihood of a consumer to pay off debt without being more than 90 days late at any time in the future. Credit scores can range between a low score of 350 and a high score of 850. The higher the score, the better it is for the consumer, because a high credit score translates into a low interest rate. This can save literally thousands of dollars in financing fees over the life of the loan.

Only one out of 1,300 people in the United States have a credit score above 800. These are people with a stellar credit rating that get the best interest rates. On the other hand, one out of every eight prospective home buyers is faced with the possibility that they may not qualify for the home loan they want because they have a score falling between 500 and 600.

The following chart illustrates how an underwriter interprets the credit score in terms of risk, and how the interest rate is affected as a result. Mortgage lenders consider a score of 700 or above to be very good.



The Five Factors of Credit Scoring

Credit scores are comprised of five factors. Points are awarded for each component, and a high score is most favorable. The factors are listed below in order of importance.

PAYMENT HISTORY – 35% IMPACT

Paying debt on time and in full has the greatest positive impact on your credit score. Late payments, judgments and charge-offs all have a negative impact. Missing a high payment will have a more severe impact than missing a low payment, and delinquencies that have occurred in the last two years carry more weight than older items.

OUTSTANDING CREDIT BALANCES – 30% IMPACT

This factor marks the ratio between the outstanding balance and available credit. Ideally, the consumer should make an effort to keep balances as close to zero as possible, and definitely below 30% of the available credit limit when trying to purchase a home.

CREDIT HISTORY – 15% IMPACT This portion of the credit score indicates the length of time since a particular credit line was established. A seasoned borrower will always be stronger in this area.

TYPE OF CREDIT – 10% IMPACT

A mix of auto loans, credit cards and mortgages is more positive than a concentration of debt from credit cards only.

INQUIRIES – 10% IMPACT This percentage of the credit score quantifies the number of inquiries made on a consumer's credit within a six-month period. Each hard inquiry can cost from two to 25 points on a credit score, but the maximum number of inquiries that will reduce the score is ten. In other words, 11 or more inquiries within a six-month period will have no further impact on the borrower's credit score. Note that if you run a credit report on yourself, it will have no affect on your score. Remember that the credit score is a computerized calculation. Personal factors are not taken into consideration when a credit report is generated. It is merely a snapshot of today's credit profile for any given borrower, and it can fluctuate dramatically

Disputing Errors On the Credit Report

If you are in the process of reviewing your credit reports, the first thing to do is make sure that the information contained within the reports is correct. In June 2004, The U.S. Public Interest Research Group published the results of a survey it conducted involving 200 adults in 30 states to test the validity of credit reporting. Their findings were as follows:

Seventy-nine percent (79%) of the credit reports contained mistakes of some kind;

Fifty-four percent (54%) of the credit reports contained personal demographic information that was misspelled, long-outdated, belonged to a stranger, or was otherwise incorrect;

Thirty percent (30%) of the credit reports contained credit accounts that had been closed by the consumer but incorrectly remained listed as open.

SOURCE: U.S. Public Interest Group Research; *One In Four Credit Reports Contains Errors Serious Enough To Wreak Havoc For Consumers*, US PIRG Press release, 06/17/04
<http://uspirg.org/uspirgnewsroom.asp?id2=13650om> If you find that you have errors on your credit report, follow this procedure to correct those errors.

1. Make a copy of the report and circle the items you are questioning. Keep original for your own records.
2. Prepare a letter to the CRA that provided you with the report in question, and request to have the erroneous item(s) removed. If you have proof of payment for an item in question include a copy of that documentation
3. Prepare a letter to the creditor reporting the problem, especially if you feel you are a victim of fraud or identity theft. Inform the creditor that you are disputing an error reported to the CRA, state why the claim is inaccurate, and include any relevant documentation to prove your point.
4. Send your correspondence via certified mail. You should receive a response from the CRA within 30 to 45 days. If the error has been corrected, they will send you a fresh copy of your credit report at no charge to show you that the item has been removed. They will also send a corrected report to any entity that received a report that contained errors within the last six months. If you cannot have a disputed item removed, you have the right to include your side of the story on the credit report. Your statement should be a concise explanation (100 words or less) as to why you are challenging the item in question. From that point on, this notation will be included in your credit report as long as the item in question remains on your report.

What If I Have No Credit?

A borrower will sometimes not have enough credit references to obtain the loan they wish to secure. In this case, start by opening small lines of credit that report to one of the three major CRAs, and make purchases that can be paid off easily. If you do not already have a checking or savings account, open one. Your bank or credit union may be able to provide you with a credit card account once you have established a history with them as a customer. Ask your family or spouse to add you to their credit card account. By adding your name to an established line of credit, you can ride on their coattails, so to speak, and gain points by using that person's credit history. It is also wise to start saving money for the down payment on your home. The lender will look at your application more favorably when you are able to come to the table with a 20% down payment. Bear in mind, there are certain loan programs available that permit a percentage of gift money for down payment, which can come from a relative.

Credit Remediation

If you feel you would prefer to work with a credit repair service rather than try to tackle credit repair issues on your own, please give us a call so we can help you sort through your options. We will do our best to refer you to a reputable credit remediation service and guide you in the right direction once we have the opportunity to review your credit report with you.

The Federal Trade Commission (FTC) regulates credit repair services and provides free information to help consumers spot, stop and avoid doing business with credit repair companies that are not reputable. Their web site is located at

<http://www.ftc.gov>.

Do's and Don'ts During the Loan Process

When you fill out a credit application, we run a credit report for the underwriter. Each lender and each loan program has different guidelines they must follow. You should not do anything that will have an adverse affect on your credit score while your loan is in process. We know it's tempting...If you're moving into a new home, you might be thinking about purchasing new appliances or furniture, but this is really not the right time to go shopping with your credit cards. You'll want to remain in a stable position until the loan closes and give us the opportunity to help you lock in the best interest rate we can possibly get for you. Here is a handy list of do's and don'ts that you should adhere to after your loan application has been submitted to the lender.*

DON'T APPLY FOR NEW CREDIT OF ANY KIND – If you receive invitations to apply for new lines of credit, don't respond. If you do, that company will pull your credit report and this will have an adverse effect on your credit score. Likewise, don't establish new lines of credit for furniture, appliances, computers, etc.

DON'T PAY OFF COLLECTIONS OR CHARGE-OFFS – Once your loan application has been submitted, don't pay off collections unless the lender specifically asks you to in order to secure the loan. Generally, paying off old collections causes a drop in the credit score. The lender is only looking at the last two years of activity.

DON'T CLOSE CREDIT CARD ACCOUNTS – If you close a credit card account, it can affect your ratio of debt to available credit which has a 30% impact on your credit score. If you really want to close an account, do it after you close your mortgage loan.

DON'T MAX OUT OR OVER CHARGE EXISTING CREDIT CARDS – Running up your credit cards is the fastest way to bring your score down, and it could drop up to 100 points overnight. Once you are engaged in the loan process, try to keep your credit cards below 30% of the available credit limit.

DON'T CONSOLIDATE DEBT TO ONE OR TWO CARDS – Once again, we don't want you to change your ratio of debt to available credit. Likewise, you want to keep beneficial credit history on the books.

DON'T RAISE RED FLAGS TO THE UNDERWRITER – Don't co-sign on another person's oan, or change your name and address. The less activity that occurs while your loan is in process, the better it is for you.

DO JOIN A CREDIT WATCH PROGRAM – Your bank, credit union or credit card company may be able to provide you with a free credit watch program that can alert you to any changes in your credit report. This can be a safeguard to help you intervene before the underwriter sees a problem.

DO STAY CURRENT ON EXISTING ACCOUNTS – Late payments on your existing mortgage, car payment, or anything else that can be reported to a CRA can cost you dearly. One 30-day late payment can cost anywhere from 30 to 75 points on your credit score.

DO CONTINUE TO USE YOUR CREDIT AS YOU

NORMALLY WOULD – Red flags are easily raised within the scoring system. If it appears you are diverting from your normal spending patterns, it could cause your score to go down. For example, if you've had a monthly service for Internet access billed to the same credit card for the past three years, there's really no reason to drop it now. Again, make your changes after the loan funds.

DO CALL YOUR LOAN CONSULTANT – If you receive notification from a collection agency or creditor that could potentially have an adverse affect on your credit score, call us so we can try to direct you to the right resources and prevent any derogatory reporting to credit bureaus.

* SOURCE: Based on The Top 10 Credit Do's and Don'ts During the Loan Process, provided by Credit Resource Corp. <http://www.creditresourcecorp.com>