"FICO 101" Educating Yourself About Credit Scores

Here is some brief information about your credit scores, how they work and how they affects the loan approval process when buying a house.

Credit scores are a way of taking lengthy credit reports and summarizing the quality of your credit in a single number. Each bureau generates its own score. Because every creditor does not report to every bureau, because they do not share information with each other and because each bureau uses a different formula to generate the scores, each of the three bureaus' scores will vary from the others. *Note that wide variations in scores are often indications of mistakes in reporting credit information.*

Only one bureau's score is actually called a "FICO" score but, since the computer software that each bureau uses to create your score comes from the **F**air **I**saac **CO**mpany, it is common to call every score a **FICO** score.

Here is an approximate breakdown of how credit bureaus assess your FICO score; in other words, the importance of various factors:

- Payment history (35%). Even just a couple of missed payments can affect credit history.
- Amounts owed (30%). Keeping debt within affordable limits is a sign of financial health.
- Length of credit history (15%). The longer the credit history, the better the score.
- New credit (10%). Agencies will check to see if a lot of credit cards were opened recently or if there were credit checks for large purchases (cars, etc.).
- Types of credit in use (10%). Usually, at least three different lines of credit are needed to qualify to buy a home.

While non-conforming loans may be able to help if you have damaged credit, it is still best to concentrate on improving scores, if at all possible. Here are a few tips:

- Apply for and open new credit accounts only when necessary. Do not open accounts just to have a better credit mix; it probably won't raise their score and new, untested, credit accounts often lower scores.
- Manage credit cards wisely. Having credit cards (and making timely payments) can raise your score, but making timely payments and maintaining a balance that is less than 50% of your limit is most important.
- Closing an account doesn't make it that account's credit history go away. A closed account will still show up on their credit report, and may be considered by the score.
- Scores are affected by old derogatory information, but the older the information is, the less affect it will have on the scores.
- Believe it or not, you can show a lack of scores if you use none of your credit within the last 6 months. So, use your credit accounts, but use them wisely. You will be best off if you have about 3-4 active accounts with one or two that are at least 24 months old with limits over 2500, plus at least a year of rental or mortgage history.

Raising your scores will allow you to obtain a mortgage with:

- Lower interest rates, down payment, discount points & fees
- Less required documentation (sometimes almost none, except for the appraisal)
- A smaller amount of equity
- Less income and smaller cash reserves after settlement

If your FICO score lies between 500 and 640, you can still qualify for non-conforming home loan solutions. For those who have the additional challenge of either looking to buy in an expensive area or just don't have a lot of cash to invest up-front, ask us about other options that can maximize you buying power.