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**CREDIT SCORES:**

*What They Are and Their Increasing Importance to Lenders*

If you have been in the market for a mortgage loan recently, whether to purchase, refinance or obtain a home equity line, you have most likely heard a new term in the mortgage industry lingo: credit score.

What is a credit score? And why is knowing about credit scoring important to you?

Q. What is a credit score?

A. A credit score is a number, ranging from the high 300's to the mid - 800's, which is developed from information contained in your electronic credit files maintained by the three private credit repositories: Equifax, Trans Union, and Experian (formerly TRW). It's commonly referred to as a "FICO" score, because the scoring model widely used by lenders was developed by the Fair, Isaac & Co. Your credit score represents your credit risk - how likely you are to repay a loan.

Q. How is my credit score derived?

A. All of the information in your credit file is analyzed. Your score is then calculated, based on many factors, some of which are: your credit payment history (have you been late with payments? frequently? recently?); mortgage rates have a more serious affect on your score.

- How you utilize your available credit (have you maxed out your credit cards?).
- The number of recent credit inquiries (are you incurring more debt?).
- The types of credit you use (do you have a lot of finance company accounts?).
- Legal items filed against you like judgments, liens, bankruptcy, foreclosure).
- Length of credit history.

The scoring model considers each of these variables, weighs each factor according to a formula, and then ultimately yields a single composite score. According to Fair, Isaac & Co., the two most heavily weighted factors are past payment history and credit utilization. The factors of age, race, gender, religion, national origin, marital status, employment, income and where you live are not evaluated. Although Fair, Isaac & Co. provide data to support the validity of their scores, scoring models are proprietary and they do not publicly release information about exactly how the formulas work.

Q. Is credit scoring new?

A. Credit scoring has actually been around since the mid- 1950's, used for approving credit cards and auto loans. However, it is only in the past few years that credit scoring has been used by mortgage lenders, so most consumers are not aware of it.

Q. Why are mortgage lenders using credit scores?

A. Mortgage lenders believe that credit scoring accurately assesses credit risk and predicts loan performance: high scores represent a greater likelihood of repayment and lower scores represent a greater risk of delinquency. This belief is substantiated by an analysis performed in 1996 by economists at the Federal Reserve Board that confirms the correlation between credit scores and loan performance. Additionally, investors who purchase mortgage loans have also endorsed the use of credit scoring: they now price loans (determine the interest rate) based, in part, on credit scores. Since the three private credit repositories (Equifax, Trans Union and Experian) each have their own credit scoring model, and consequently give their own individual credit score to your credit file, lenders typically use the middle of the three scores when underwriting your loan.

Q. What is a "good" credit score?

A. Credit scores are broken down into three ranges: a score of 680 and above is considered a low risk borrower; a score of 620-680 is considered medium risk; and a score of less than 620 is considered high risk. In the medium risk range, other factors, such as loan-to-value and debt ratios, are taken seriously into consideration by the mortgage underwriter. So, if a person has a 625 credit score, but has low loan-to-value and debt ratios, he/she is looked at more favorably.

Q. Why should I care about having a high credit score?

A. The primary reason is that your credit score is a major factor in determining the interest rate you will pay for your loan. Borrowers with low credit scores (high risk) are given higher interest rates than borrowers with high credit scores (low risk). Almost every lender now uses credit scoring as a factor in pricing loans.

Q. How do I find out what my credit score is?

A. You can contact each of the three private credit repositories for a copy of your credit file, which includes their individual credit score: Equifax @ 800-685-1111; Trans Union @ 800-916-8800; Experian @ 800-682-7654.

Or call Steve Betow of People's Home Mortgage at (952) 844-1557.

Q. How can I improve my credit score?

A. First, and foremost, review your credit file from each of the three private credit repositories for accuracy, and begin immediately to correct errors. Then, according to Fair, Isaac

& Co., the three key things to remember are to pay your bills on time, keep credit card balances low, and apply for new credit sparingly. All of these things will make you a good credit risk and produce a high credit score.

Q. Why is credit scoring so controversial?

A. One reason is that credit scores are calculated on the raw data found in your electronic credit file, which is not always accurate. And correcting inaccurate information can take a lot of time. The scores also do not take into consideration such variables as a recent illness, job loss or the like, which can temporarily affect credit. For these reasons, as well as several others, many feel that credit scoring should be approached cautiously and not be given too much weight in the final decision of whether to grant a mortgage loan. However, the use of credit scoring as an evaluative tool is increasing dramatically in the mortgage lending industry, so consumers need to be aware of it and how it is used.

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