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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 or promotion that you want and deserve. 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 management or financial responsibility.



The History of Credit Scoring

The credit score system used today has evolved since the 1950s. 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.

DON'T DISPUTE ANYTHING ON YOUR CREDIT REPORT once the loan process has started. When you send a letter of dispute to the credit reporting agencies, a note is put onto your credit report, and when the underwriter notices items in dispute, in many instances, they will not process the loan until the note is removed and new credit scores are pulled. Why? Because in some instances, credit scoring software will not consider items in dispute in the credit score—giving false data to the lender.

DON'T DO ANYTHING THAT WILL CAUSE A RED FLAG TO BE RAISED BY THE SCORING SYSTEM. This includes the not-so-obvious things like cosigning on a loan or changing a name or address with the bureaus. The less activity on a report during the loan process, the better.

MOST IMPORTANTLY – DO STAY IN CONTACT WITH YOUR MORTGAGE AND REAL ESTATE PROFESSIONALS. If you have a question about whether or not you should take a specific action that you believe may affect your credit reports or scores during the loan process, your mortgage or real estate professional may be able to supply you with the resources you need.

*SOURCE: Linda Ferrari's Book, *The Big Score – Getting It & Keeping It*, www.lindaferrari.com.

Credit Remediation

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 www.ftc.gov.

You can also write to the FTC to request a copy of their free brochure titled *Credit Repair: Self Help May Be Best*, which includes information about credit clinics. The address to write to is:

Federal Trade Commission
Sixth and Pennsylvania Avenues, NW
Washington, DC 20004

If you have any complaints regarding your credit report or credit remediation services that you wish to report to the FTC, contact them at:

Federal Trade Commission
Consumer Response Center, Room 130
600 Pennsylvania Avenue, NW
Washington, DC 20580

DON'T APPLY FOR NEW CREDIT OF ANY KIND. Including those “You have been pre-approved” credit card invitations that you receive in the mail or online. Every time that you have your credit pulled by a potential creditor or lender, you lose points from your credit score immediately. New credit also brings a credit score down. Depending on the elements in your current credit report, you could lose anywhere from one to 15 points for one hard inquiry.

DO PAY BILLS ON TIME. Stay current on existing accounts. Under the new FICO scoring model, one 30-day late can cost you anywhere from 50-100 points, and points lost for late pays take several months if not years to recover.

DON'T PAY OFF COLLECTIONS OR CHARGE OFFS during the loan process. Unless you can negotiate a delete letter, paying collections will decrease the credit score immediately due to the date of last activity becoming recent. If you want to pay off old accounts, do it through escrow—at closing.

DON'T MAX OUT OR OVER CHARGE ON YOUR CREDIT CARD ACCOUNTS. In the matter of fact, DON'T charge on credit cards at all if possible. This is the fastest way to bring your scores down 50-100 points immediately. Keep your credit card balances below 30% of their available limit at ALL times during the loan process. And if you decide to pay down balances, do it across the board. Meaning, pay balances to bring your balance to limit ratio to the same level on each card (i.e. all to 30% of the limit, or all to 40% etc.)

DON'T CONSOLIDATE YOUR DEBT ONTO 1 OR 2 CREDIT CARDS. It seems like it would be the smart thing to do, however, when you consolidate all of your debt onto one card, it appears that you are maxed out on that card, and if you want to save money on credit card interest rates, wait until after closing.

DON'T CLOSE ACCOUNTS. If you close a credit card account, you will lose the total amount of available credit you have, and this may impact your credit scores. Also, closing a card or installment account may impact other factors to your score such as the length of your credit history. DO NOT close credit cards until after closing.

DON'T ALLOW ANY ACCOUNTS TO RUN PAST DUE—EVEN 1 DAY! Most cards offer a grace period, however, what they don't tell you is that once the due date passes, that account will show a past due amount on your credit report. Past due balances can also drop scores by 50+ points.

If you decide to take advantage of this program, please keep in mind that annualcreditreport.com does not offer free credit scores with your reports. However, you can purchase your score at the same time that you order your free report for around \$7.95 per bureau. To have a complete picture of where you stand with your credit, it is always recommended that you order your scores at the same time.

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 have many different ranges, however, the score that is used by 90% of lenders and creditors in this country is the FICO score, and the FICO score range is 300 to 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 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.

1. 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. Delinquencies that have occurred in the last two years carry more weight than older items.

2. Outstanding Credit Card 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 at least 2-3 months prior to trying to purchase a home.

3. 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.

4. 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. You should always have 1-2 open major credit card accounts.

5. Inquiries – 10% Impact

This percentage of the credit score quantifies the number of inquiries made on a consumer's credit within a twelve-month period. Each hard inquiry can cost from three to fifteen points on a credit score, depending on the amount of points someone has left in this factor. Note that if you pull your credit report yourself, it will have no effect 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 within the course of a week.

These are just a few tips to consider as you seek to obtain mortgage financing. As soon as you begin to make mortgage payments on time and in full, your credit standing will begin to improve.

Dos and Don'ts During the Loan Process

When you fill out a credit application, lenders 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 effect 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.

Under the new requirements of Fannie Mae & Freddie Mac, and even FHA in some instances, lenders may be pulling your credit report a second time 1-3 days before closing. What this means is that if your credit scores have dropped, if you have applied for other credit accounts, or your debt-to-income ratio has changed, you may no longer qualify for the rate that was underwritten. This re-pull of your credit reports and scores could delay the closing of your loan, and in worst case scenario – could cause denial altogether.

Following are some helpful tips to avoid the credit mistakes that many borrowers make during the loan process:*

DO JOIN A CREDIT WATCH PROGRAM so that you can monitor your credit from shopping to closing. Pulling your own credit on-line WILL NOT HURT YOUR CREDIT SCORES. But here's what you need to know. Be sure to look for a company that uses a score range as close to 300-850 as possible (the lender score range). Some on-line companies use a range of 501-990 which will lead you to believe that your scores are higher than they really are. For a small fee, usually less than \$15 per month, you can pull your credit reports and scores from all three bureaus every 30 days at www.privacyguard.com. And these companies will let you know instantly if there has been a change to your credit profile.

Dealing with Credit Challenges

Unfortunately, bad credit scores are mostly a result of late or unpaid and outstanding bill payments. Of course, there are exceptions when unforeseen circumstances come into play, such as health complications or loss of employment.

Here are some tips to improve your credit score in the short term to secure a better interest rate on your mortgage loan.

Example 1: Distribute debt from revolving credit.

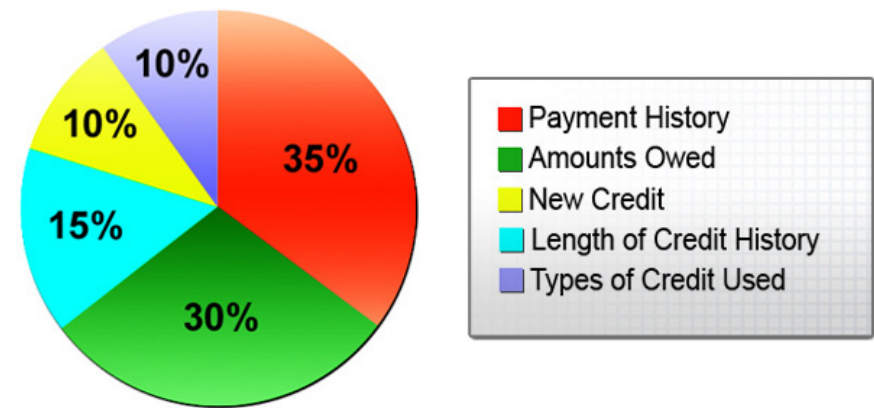
Our borrower, Mr. Jones, has a credit score of 664. He has five credit cards, but his Visa account is almost maxed out. His other four credit cards have relatively low balances. Mr. Jones moves part of the debt from the Visa account to the other major credit card accounts, thus distributing the debt more evenly over the five cards. This changes the ratio of debt to available credit (which has a 30% impact on the overall credit score), and Mr. Jones successfully raises his credit score by 20 points with very little effort. It's important to note that when making balance transfers like these, you should make sure that the balances-to-limit ratios are kept under 30% if you are planning to get a loan in the near future. Also note that if transferring monies from one card to others brings any of these balances over 50% of the limit, your credit score will drop.

Example 2: Transfer outstanding balances to new accounts.

Our borrower, Mr. Smith, has only two credit cards, but both are pushing the limit of available credit. Mr. Smith opens two new credit card accounts, each with a credit limit of \$5,000. He transfers part of his existing balances to the new accounts. While he has acquired two new cards that have no established history, the greater impact is the change in the ratio of debt to available credit.

Ultimately, experts say that it is best to have one to three major credit cards, and no more than that. You should keep your balances as low as possible. If you have a credit account with a zero balance, do not close the account.

Instead, make a small purchase so the card shows up as an active account on your credit report, and you will be awarded points for your long-term credit history.



How Does a Low Credit Score Affect My Interest Rate?

1. You May Never Own a Home Again

Whether or not you've always had poor credit, or have just suffered from the recent mortgage crisis, this is a very real possibility for individuals. If you have low scores or problematic reports, lenders will either deny you flat out or penalize you with such exorbitant rates that the outcome ranges from completely undesirable to impossible.

2. You Will Pay Higher Interest Rates

It just makes sense that if you have higher credit scores, you will pay a lower interest rate on your mortgage loan and will have to put less down. Fair Isaac's consumer website myfico.com offers a mortgage payment calculator that is updated regularly to show consumers how their FICO score can affect their interest rate.



Per myfico.com, for a 30-Year Fixed Rate Mortgage with a loan principal amount of \$300,000, if you improve your credit score from 620 to 720, you could save \$110,000 over the life of the loan in interest.

Of course, interest rates are determined by many factors but the bottom line is that individuals with *low credit scores will pay nearly three times more in interest than those with strong credit scores.*

3. You May Pay Higher Closing Costs

Consumers with lower credit scores may be subject to higher closing costs. Known as rate add-ons, these are fees based on your loan amount, implemented by Fannie Mae and Freddie Mac in 2010 to accommodate for the risk associated with lower credit borrowers. See the table below for sample rate add-ons based on credit scores.

FICO Score	Rate Add-On You Will Pay
<659	3.250%
660-679	2.750%
680-699	1.750%
700-719	1.000%
720-739	0.500%
740 >	0.250%

In this scenario, a FICO score under 659 could cost an extra \$9,750 on a \$300,000 loan amount.

4. You Will Pay More For Private Mortgage Insurance (PMI)

PMI is insurance that mortgage lenders require from most homebuyers who have less than a 20% down payment on their property. If your credit scores are marginal, your private mortgage insurance rate might be hundreds of dollars higher per month than you expect, and you usually don't find this out until closing.

5. You Will Compromise Your Ability To Refinance For “Cash Out”

As you build equity in the ownership of your home, you may decide to borrow against that equity for the purpose of home improvement, debt consolidation, or even to pay college tuition for your children. Lower credit scores will not only affect your ability to take out a home equity line of credit (HELOC), but you will also have to pay higher interest rates and other upfront costs if you are approved.

SOURCE: Linda Ferrari's Book, *The Big Score – The Cost of NOT Paying Attention*, www.lindaferrari.com.

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?

On occasion, borrowers will not have enough credit references to obtain the loan they wish to secure. If this is the case for you, start by opening small lines of credit that report to all 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.



If you do not have established credit, you are not completely out of luck. Some lenders will pull a report that will show them whether or not consumers pay their rent and utility bills on time. If they like what they see, they may approve you for credit. That is why it is extremely important to pay these day-to-day living expenses on time. In addition, your ability to hold a steady job will improve the likelihood of being approved for credit.

Another option would be to obtain a secured credit card. A secured card may be an excellent way for a person with no credit to establish credit. This type of card works like a debit card and will require deposited funds for purchases—the main difference being that your credit history will be reported to the three credit bureaus. Do your research up-front however, and ensure that they do so. Also be advised that not all banks or credit unions offer secured credit cards, and some cards may even charge application and other fees.

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.

- Send your correspondence via certified mail and, to avoid delay in their replies, always attach proof of social security and proof of address right from the beginning.

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 or corrected.

If the bureaus do not respond within 35 days, send a formal complaint letter reminding them that per Section 611 of the Fair Credit Reporting Act they are required to respond within 30 days from the date they received your initial dispute. Also remind them that per Section 616 & 617 of the same Act they are liable for damages, including punitive, and that if necessary you will seek legal representation. Attach your original dispute letter and proof of delivery to the complaint.

In addition, just because the credit bureau has determined an item “investigated” does not mean the results are accurate. If you are 100% sure that your claim is true and accurate, and the bureau responds stating that the creditor has verified the information and the item will not be removed or updated, you must request a reinvestigation under Section 611 of the Fair Credit Reporting Act. It’s best to do so within 5 days of receiving the results of their investigation.

You can repeat this process as many times as you want; however, after three to four attempts, you may consider filing a complaint with the Federal Trade Commission Consumer Response Center. You may be able to have your case added to a class action lawsuit against the bureau that is reporting the inaccurate information. You can access the FTC Complaint Assistant at <http://www.ftccomplaintassistant.gov>, or you can mail a complaint letter to the following address:

Federal Trade Commission
Consumer Response Center
600 Pennsylvania Avenue, NW
Washington, DC 20580

If you do not have proof in support of your claim and the CRAs refuse to remove the disputed item, you also have the right to include your side

How Does the Underwriter View My Score?

If you are considering a home purchase, it is in your best interest to make every effort to increase your credit scores as early in the process as you can, especially if you know you have issues you should be dealing with. It is often the case that people are not aware of bad marks on their credit record until they apply for financing for a major purchase, such as a home.

Today, you have access to your credit information all day, every day. This is wonderful news. Consumers now have the opportunity to quickly correct and maintain credit reports. It is mission critical for consumers to seize that advantage by assuming responsibility.



Reports from the credit bureaus. You can get started by acquiring a copy of your credit reports from each of the three major CRAs. It’s important to get reports from each of the three—not just one. The CRAs do not share data, so you need to get a full accounting of everything that is being reported.

The reports that you receive directly from the three credit bureaus are easy to read. More importantly, going straight to the source of the data will ensure that your action plan begins with the most complete information being reported about you—this includes your credit accounts, your credit history, and your personal and demographic information.

You can order your credit report and score from each credit bureau online, through the mail, or via telephone. Here is the information you need:

- Equifax: (800) 685-1111 - <http://www.equifax.com> Cost: \$15.95
- Experian: (888) 397-3742 - <http://www.experian.com> Cost: \$10.00
- TransUnion: (800) 916-8800 - <http://www.transunion.com> Cost: varies by state, but expect costs ranging from \$10.00 to 15.00

Be sure to call for the most recent mailing information when you are ready to contact the bureaus by mail.

Free credit reports. By law, each of the CRAs must provide a free copy of your credit report, at your request, once every 12 months. To read more about this, a good source is the Federal Trade Commission's Consumer Alert that you can download at - <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt156.pdf>.

You can request your free credit reports in three ways.

- a) Go to <http://www.annualcreditreport.com>; or
- b) Call 1-877-322-8228; or
- c) Complete the Annual Credit Report Request Form and mail it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. You can download the form with instructions at <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt156.pdf>.

Remember, [annualcreditreport.com](http://www.annualcreditreport.com) does not offer free credit scores with your reports. However, you can purchase your score at the same time that you order your free report for around \$7.95 per bureau. To have a complete picture of where you stand with your credit, it is always recommended that you order your scores at the same time.

The underwriter who is making the decision as to whether or not you should get the loan you are asking for will generally look at the scores generated from all three CRAs. Typically, the score will not be the same from all three reports, and the underwriter will consider the middle score as a barometer.

SOURCE: Linda Ferrari's Book, *The Big Score – Getting Your Reports*, www.lindaferrari.com

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. The U.S. Public Interest Research Groups (USPIRGs), conducted a 30-state study on the subject of credit scoring, and published their own report:

Mistakes Do Happen: A Look at Errors in Consumer Credit Reports. The study revealed that 79% of consumer credit reports contain errors. What's more, there's a one-in-four chance your credit report contains an error serious enough to cause you to be denied credit.

Here's a breakdown of their findings:

- Twenty-five percent (25%) of the credit reports contained errors serious enough to result in the denial of credit;
- 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=13650&id3=USPIRGnewsroom>

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 item(s) you are questioning. Keep your original copy 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 or corrected. If you have documented proof in support of your claim (i.e. proof of payment, etc.) be sure to include a copy of that documentation with your dispute letter.
3. In addition, prepare a letter to the creditor reporting the item on your credit reports, 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.