Understanding Your Credit Score

What it is.
What it means.

You may have heard of credit scores and wonder what they are. How do they affect your ability to get a loan? How do they affect the interest rate and points you have to pay? You may wonder whether your credit score is accurate. The key is to make doing business with a lender easier and more affordable. Part of this process involves making sure you are informed every step of the way. This pamphlet explains credit scores and how to improve your score. On the last page of the pamphlet, you'll find references where you can get more information on this topic.

What Is A Credit Score?

When lenders evaluate your loan application – a process called underwriting – they try to evaluate your ability and willingness to repay your loan. They judge your ability to repay by looking at your income and how stable your past earnings have been. This helps them to determine if you can afford the loan payments. They judge your willingness to repay by looking at your past credit history. Generally speaking, someone who has made payments on time in the past will probably do so in the future.

Lenders want their evaluation to be as accurate, objective and consistent as possible. To help achieve these goals, home mortgage lenders recently began using credit scores to help in the underwriting process. Credit scores are numerical values that rank individuals according to their credit history at a given point in time. Your score is based on your past payment history, the amount of credit you have outstanding, the amount of credit you have available, and other factors. According to Fannie Mae and Freddie Mac, two large investors in mortgage loans, credit scores have proven to be very good predictors of whether a borrower will repay his or her loan.

Credit scores are used to help lenders evaluate your home loan application. However, a credit score is just one of many factors lenders consider. Lenders look at the whole person. Even when a credit score is low, lenders try to find other factors that could overcome the negative credit issues and satisfy the underwriting criteria. Most lenders would not deny a loan application simply based on credit score. The decision to approve or deny a loan application will be made based on sound, flexible underwriting guidelines.

What is a FICO Score?

"FICO" scores are a type of credit score developed by Fair Isaac & Company. FICO scores use credit bureau information to obtain a score which indicates how likely someone is to make their loan payments on time. Millions of consumers' credit bureau records were used to develop score cards, and all of the consumer data – not just negative information – was included to develop the system. FICO scores range from approximately 350 to 900. The higher the score, the lower the probability of default on the loan.

How Can Credit Scores Affect The Price Of Your Loan?

Just as credit scores are one factor in determining if you qualify for a loan, they may also be a factor in determining the price of your loan. The price of a loan means the interest rate and the points charged by the lender. The price charged for a loan will be higher or lower depending on various factors.

Credit scores are used in determining the price of a loan because they are believed to be good predictors of a borrower's ability and willingness to repay the loan. Therefore, applicants with lower credit scores may pay higher prices for their loans because of the higher risk of default and loss on the loan. Many home loans are sold to investors, and investors will pay a more favorable price for loans they feel have a low risk of default. Fannie Mae and Freddie Mac, use credit scores as part of their analysis when pricing loans they buy from lenders because of this very reason.

There are many other factors relating to an individual borrower's situation that may also affect the price of a loan – often even more so than credit scores. These include: the type of property securing the loan (detached single family residence, duplex, condominium, etc.); the amount of the borrower's equity in the property; the value of the property compared to property values in the area generally; the lender's costs to make the loan; and the type of loan selected. For example, a loan secured by a single family residence may have a lower price than a loan secured by a condominium because condominiums may be more difficult to sell than single family residences. Similarly, the price of a loan where the borrower has made a 20% down payment may be less than a loan where the borrower has more equity in the property and, thus, a greater incentive to make the payments on the loan.

How Can I Improve My Credit Score?

Because each borrower's credit score is a reflection of his or her unique credit profile, it is not possible to quantify in advance how each item in your credit history impacts your credit score. No one can tell you, for example how much your credit score will be affected if you pay off a delinquent account or cancel a credit card. We do know, however, that there are things you can do to improve your credit profile. Some of these factors include:

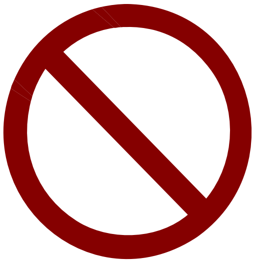
Making Timely Payments. Making your payments on time is the best way to increase your score. Delinquencies, foreclosures, bankruptcies, and judgments will decrease your score.

The Number of Trade Lines. The number of credit cards, lines of credit and other types of credit ("trade lines") you have available will affect your score. If you have a lot of trade lines, this may decrease your score because of the risk that you might not be able to pay off all of your accounts, and this may affect your ability to pay off your mortgage loan. You may wish to consider canceling credit cards you do not use regularly or choosing 2-4 cards to use and canceling the rest. If you close or cancel an account voluntarily, it will not have a negative effect on your credit score. You may wish to reconsider accepting "pre-approved" offers for credit cards, or if you accept an offer, perhaps you should cancel another credit card. On the other hand, of you have no trade lines, this will likely decrease your credit score. Lenders generally want to see that you have some available credit and that you can handle your credit wisely.

How You Use Credit. The amount outstanding on each of your credit cards will also affect your score. In general, the lower the amount outstanding, the more likely it is that your score will be higher.

Do Not Apply For Credit You Do Not Need. Whenever you apply for credit, the creditor will obtain a credit report from one or more the three credit bureaus. Each credit inquiry will stay on your record and will affect your credit score. Even if you are turned down for the credit or change your mind and withdraw your application, your credit score will be affected. This is because each inquiry suggests that you are increasing the amount of credit available to you. Before you give your Social Security Number to someone, make certain you know how they are going to use it. A Social Security Number is almost always required to run a credit report. But don't let the fear of inquiries stop you from shopping for the best deal when you need auto or home financing. Recently, the credit bureaus have recognized that borrowers may apply for credit at more than one place for the same transaction. Generally, the credit scoring companies will consider all auto or mortgage loan inquiries received within a 14 day period as one inquiry so the additional inquiries will not affect your credit score.

We encourage you to obtain a copy of your credit report and to review it for accuracy before submitting your loan application. If you find and errors, correcting them prior to submitting your loan application may result in a better likelihood your application will be approved and also that the time for approval will be lessened. And remember, when you order a copy of your credit report to make sure it's accurate, this will NOT show up as an inquiry on your record.



How To Correct Mistakes On Your Credit Report.

Because credit scores are based upon your credit record, it is very important that you obtain a copy of your credit report from time to time to make certain the information is accurate. If the information is not accurate (for example, someone else with the same name as yours may have their credit mixed up with yours), you should immediately take steps to get it corrected. No one can do this but you.

Lenders, credit card issuers and other credit providers send regular reports about the accounts to the major credit bureaus. This is where the information on your credit report comes from. There are three major credit bureaus; you should contact each one because not all providers of credit report to each bureau. Also, if you have joint credit (for example, if you are married and have joint accounts with your spouse), it is a good idea to get the credit report for each of you because there may be information on one report that does not appear on the other. If you ask for a copy of your credit report to check your credit history, it will not affect your credit score.

You can reach the three credit bureaus at the following phone numbers:

Equifax: 800-685-1111
TransUnion: 800-888-4213
Experian (TRW): 800-682-7654

In most cases, there is a small charge to obtain a copy of your credit report. If you find errors on your report, follow the directions included in your report regarding disputes or errors. Generally, you must write the credit bureau and advise them of the error or dispute. You may need to provide proof that the bill was paid or other information about the claim or dispute. The credit bureau will then contact the provider of credit who reported the information, and that the provider will have 30 days to respond. If the provider of credit agrees that there is an error, it will instruct the credit bureau to delete the item from your credit report.

You should allow at least 30 days after you have notified a credit bureau of an error in your credit report for that error to be investigated and resolved. It may take longer depending upon the nature of the error and the investigation to be done.

Materials To Review.

Listed below are some of the materials to help you understand more about credit scores and solving credit problems.

Fair Isaac & Company; 120 North Redwood Dr, San Rafael, CA 94903
Answers to Your Questions About Credit Scoring: A Consumer's Guide to Scoring
http://www.fairisaac.com

Board of Governors of the Federal Reserve System; Washington D.C.
Bulletin, Volume 82, Number 7, July 1996 "Credit Risk, Credit Scoring and the Performance of Home Mortgages"

Freddie Mac; 8200 Jones Branch Dr, McLean CA 22101; 800-FREDDIE
Credit Scores: A Win/Win/Win Approach for Homebuyers, Lenders and Investors
Automated Underwriting: Making Mortgage Lending Simpler and Fairer for America's Families http://freddiemac.com

Office of the Comptroller of the Currency; Washington D.C. Bulletin 97-24: Credit Scoring Models

Federal Trade Commission; Washington D.C.
http://www.ftc.gov/bcp/conline/pubs/credit/scoring.htm

Associated Credit Bureaus, Inc 1090 Vermont Ave N.W., Washington D.C.
"What You Should Know About Your Credit Record"
"Fix Your Own Credit Problems and Save Money"
"Code of Ethics in Credit Reporting"
"Solving Credit Problems"
"Building a Better Credit Record"