

Why is Credit Important?

Credit scores are an instrument used by any lending institution to evaluate risk. Credit scores may lead to lower interest rates when borrowing money in any facet- automobiles, mortgages, installment loans, revolving credit cards/ lines of credit, and any type of insurance. Credit scores fall as one of the three essential elements in gaining mortgage loan approval by Fannie Mae, Freddie Mac, FHA and VA. Scores will also play a vital role in attaining affordable Mortgage Insurance. Credit scores and responsible borrowing may even have an affect on successful job searching. In our business it is important for us to treat the borrower as a person and if at all possible improve their lives not just their mortgage rate. Credit scoring, although seems difficult to understand, follows a fairly common sense approach.

Fair Isaac Reports

- Payment History-* Will account for 35% of your credit score. The most obvious way to control your score is to make payments on time. Mortgage and Installment loans will rely heavily on consistent payment history. These loans are usually larger and will reward points every 6, 12, 18, and 24 months if payments are paid on time.
- How much you owe-* Will account for 30% of your credit score. Maxed out revolving debt will result in loss of points. Popular belief is that as long as you pay balance in full your score will remain positive. This is not an accurate belief. Maxing out revolving debt will subtract points as well as leaving zero balances. The suggested method is to keep small balances under 30% of high limit to maximize credit points.
- New Credit-* Will account for 10% of your credit score. Too many cards reflect poorly on scores as it gives borrower more opportunity to create trouble (more so true with credit challenged individuals). Opening many new accounts in a short period of time will result in an immediate loss in points. Normally creditors will pull credit score before allowing a line of credit. This will also slightly decrease scores.
- Credit History-* Will account for 15% of your credit score. Installment and Mortgage trade lines with positive payment history will accrue credit points over time. The older the account the more value just as the larger the account the more value in terms of credit points. Closing old installment and mortgage loans (paying in full) will reward positive points as common sense applies. Closing old revolving debt will result in loss of credit points. The strategy is to continue to have revolving accounts with extensive seasoning to absorb the detriment of opening new accounts.
- Good Mixture-* Accounts for the final 10% of your credit score. Ideally an individual will want a mortgage, an installment of some sort (student loan / automobile), and revolving credit or line of credit. The idea is to have a mixture of each type of loan available to give your credit report a well rounded consistency. This goes along with the belief that a strong foundation will be able to absorb minor scuffs and blemishes.

Summary-

An ideal credit report will contain all of these factors. Payment history, amount of debt, good history to allow new debt, along with a healthy mixture of loans results in premium A+ credit scores.

Understanding how difficult it is to attain an A+ credit score, our focus will now turn to how easy it is to tarnish such a feat.

Delinquencies

A perfect score is rewarded with such advantages in interest rates and financing because of the difficulty necessary to accomplish such scores. Pristine credit scores will drop dramatically with its first delinquency. A new delinquency added to a previously perfect credit report may result in a score drop of 70-220 points. A foreclosure/bankruptcy may result in a drop of 160-220 in points. Mortgage late 40-100, Judgment 10-70, Collection 10-70, late payment 10-70.

A+	740-850
A	700-739
A-	680-699
B+	640-679
B	620-639
B-	580-619
C	560-579
C-	520-559
D	below-520

The science behind predicting score loss is all about the prior history of the individual. If the credit report was unscathed and a small collection show up for \$300 the A+ borrower may lose 50 points where the B- borrower may lose 10. If the late "fits" the report then the "punishment" is not so severe.

A+ borrowers lose points just as fast as D borrowers may be able to gain them. Borrowers with poor history will gain more points by repairing an item than borrowers with mediocre history. The borrower with poor credit will be able to increase scores into the B+ by making payments on time, paying down revolving debt and clearing collection balances and judgments. This may only take a year. In order to move from B+ to A will take the same steps but it may take two years or more to find yourself back in A paper land.

Paying Off Old Debt

- Bankruptcy- 7-10 years to fall off report
- Judgment- 7-10 years to fall off report
- Collection- 5-7 years to fall off report

Collections, Judgments and Charge Offs are all measured by their age. Depending on the original score and credit history, when a delinquency of this nature hits a report the effect will be different by measure but negative nonetheless. Points will be lost initially and then the line will remain idle most of the time. If this Collection, Judgment or Charge Off is paid off within two years then most, not all, of the points originally lost will be regained. If the item is paid off between 2-5 years no points will be regained and some points will be lost depending on how old. If the item is paid off after five years then it is almost as bad as the Collection, Judgment or Charge Off just appearing as if it were new. The credit report is going to concentrate on the date filed vs. the date last updated. The delinquent item will become diluted with time, don't wake it up.

If the credit report at stake is one of B rating or better and the delinquency is older than two years then it is better to pay off at closing instead of trying to remove before hand. If credit rating is below B rating then the losses will be minimal when waking up that sleeping giant for reasons that we discussed before.



Rebuilding Score

Sometimes "life happens" and poor credit scores are a result of difficult times, there are ways to make a comeback. Obviously time is the most important factor in rebuilding credit scores. In order to bring scores from D to A+ there are necessary steps to take but even after all delinquencies are cleared the credit report will need time to heal.

Assuming time is not an issue, the first thing that must be accomplished is paying off all derogatory debt. Yes, you may lose points by paying off old Judgments, Collections and Charge Offs but the idea is to remove these delinquencies first. These types of delinquencies will stand as weights on the credit score or, if you will, a ceiling. Remove these balances first. Next, obviously is to pay all credit lines that are active on time and pay balances down. If there isn't any positive debt then open two small credit cards. These cards are to be used in moderation. Keep balances down. This will establish new, clean and manageable trade lines. Suggest a secured card that reports to all credit bureaus. To maximize points pay down one card at a time to 30% or less instead of paying 3 cards down to 70%. Do not close old trade lines for that will result in loss of points, unless there are multiple open accounts. If that is the case then close the most recent. Stay consistent and then open an installment loan in order to round off credit report. Assuming the time is taken to care for these instructions then purchasing a new home will be made much easier and financially more sound.