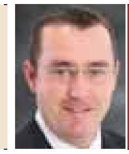

By Greg Holmes
National director of sales and marketing
Credit Plus Inc.

Giving Credit Its Due

Empower your clients with knowledge to clear the credit-score hurdle

Once your client has found a new home and put in an offer, the race begins to complete the inspection, appraisal and financing procedures that are necessary to close the deal. The home-buying process has plenty of bars to clear before a transaction can be completed, some of which may be easier to clear than others. In particular, many prospective homeowners are finding that their credit scores have turned into a hurdle in today's difficult economy.

When it comes to these scores, however, there's an easier track for borrowers to follow, one that involves mortgage brokers and originators empowering them with knowledge. Originators at least should make sure that their customers understand a few key facts about their scores and how they affect their applications.

For instance, your clients should know that one of the reasons lenders review credit scores in the first place is to determine the likelihood that they'll have a 90-day late payment sometime within the next two years. Borrowers also should know that their credit scores are fluid; changes occur as payments are made, loans are paid off and new credit applications are filed.

Many borrowers also have misconceptions about what impacts their credit scores and what doesn't. For instance, some believe that credit inquiries have the same adverse impact as a 30-day late payment or believe that paying off revolving accounts won't affect a credit score at all. Borrowers additionally need to realize that disputing accounts may invalidate their credit scores until those disputes are resolved, which in turn can delay a loan's approval.

Clearly, borrower education is necessary to ensure that your customers' credit scores are in the best-possible shape at the time of their applications. In addition to stressing the preceding points, here are additional tips and topics that originators should discuss with their clients.

The specifics

All three major credit bureaus — Equifax, TransUnion and Experian — use the FICO scoring formula developed by Fair Isaac Corp. Nonetheless, be sure to explain to your clients that scores may vary between bureaus, as each may be working with slightly different information. That's why it's important to check a client's credit report with all three bureaus and make sure that any erroneous information is corrected.

According to Fair Isaac Corp., the factors used to determine credit score include the following:

- **Payment history constitutes 35 percent of the credit score**. The number of accounts that a customer has and whether payments were made on time are factors that are critically important. Any current or previous delinquent accounts are taken into consideration, as well as how long the delinquency lasted and when it occurred. Foreclosures, collection activity, late payments, bankruptcies, liens and similar actions will affect credit scores.
- **Total debt constitutes 30 percent of the score.** This includes revolving debt (i.e., credit cards), how much is owed on each account and the percentage of the total credit limit that has been borrowed. A high ratio of debt to available credit will negatively affect a score. Keep in mind that unpaid balances that exceed 50 percent of the credit limit also will negatively affect a score, even if the person has a long payment history and has never made a late payment.
- **The length of credit history constitutes 15 percent of the score.** The length of time each account has been open, as well as how much time has passed since the account has been used, factor into the credit score. Credit histories of less than two years can be an issue, as can closing accounts that decrease the amount of available credit and eliminate important credit history. More years of responsible credit history make for better credit scores.
- **The newness of credit and the number of credit inquiries constitute 10 percent of the score.** Inquiries made about the borrower's credit report can have a negative effect on the score, particularly if the borrower initiated them by applying for credit cards or loans. Because new credit inquiries and lines of credit can lower the credit score, it's important for borrowers to resist the temptation of opening new accounts.
- **The various types of credit used constitute 10 percent of the score.** It's helpful to have a diversified credit mix that includes loans, mortgages and department- or consumer-credit cards. Having too few or too many open accounts can detract from the score.

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Greg Holmes is national director of sales and marketing at Credit Plus Inc. in Salisbury, Md. Credit Plus has been a provider of credit and mortgage-information services since 1928. Reach Holmes at beyondbundled@creditplus.com.

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Brokers and originators also should note that it's important for prospective homebuyers to avoid major purchases in the months before closing, as Freddie Mac now requires lenders to look into credit-report inquiries made against a borrower's account in the 120 days prior to closing. To help companies ensure that they're meeting the new Freddie Mac standards, the organization offers a risk-assessment tool called Loan Prospector, which provides access to Freddie Mac's credit and pricing terms and helps ensure borrowers get the lowest-cost financing that's available.

Credit-score tips

There are a number of actions that you can share with your borrowers that may impact their credit scores. That said, new rules from the Federal Housing Administration make it imperative that some of those efforts be completed 90 days before filing loan papers. For instance, disputed accounts with more than $1,000 must be paid in full or be set on repayment plans 90 days before a loan's application. Not doing so can adversely affect a person's credit score and ability to qualify for the loan in question.

Rescoring tools, which are typically available from credit-information companies, can be helpful in providing direction to borrowers on how to impact their credit scores. Such tools not only provide a detailed analysis of a borrower's score, but also enable mortgage professionals to simulate changes to determine courses of action that may be advantageous.

In addition to utilizing a rescoring tool, there are several other actions borrowers can take, such as:

- **Don't use more than half of your available credit.**
- **Keep paid-off accounts open.**
- **Apply only for the credit you need —** don't open new accounts just to get an incentive.
- **Pay your bills on time.**
- **Keep using credit cards prudently,** even if you've had problems in the past.
- **Bring all card balances under 33 percent of each card's credit limit.** If possible, shift the balance from high-balance cards to other cards to accomplish this. Do not, however, attempt to achieve this by opening another account or by increasing the line of credit on a specific card.
- **Pay at least the monthly minimum on each card to decrease balances.**
- **Freeze all major spending** and don't use any line of credit when you're trying to secure a loan.
- **Work with the credit-reporting agencies to correct errors on your account.**
- **Let experts lend a hand** and use scoring technology to reassess your score.

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As a mortgage professional, urge your borrowers to begin looking at their credit files months before applying for a loan, and then help them work their way through any issues at least 90 days in advance. By bringing your borrowers up-to-speed in these respects, you can help them clear any unexpected hurdles that may occur on their way to homeownership.