

Understanding FICO Scores and How it Affects Home Buying

Home buyers who are seeking a mortgage find out early-on that their credit score plays an important part in the home buying process and in determining the interest rate that a lender offers.

What is a credit score?

A credit score is a number that lenders use to estimate risk. Experience has shown them that borrowers with higher credit scores are less likely to default on a loan.

How are credit scores calculated?

Credit scores are generated by plugging the data from your credit report into software that analyzes it and cranks out a number. The three major credit reporting agencies don't necessarily use the same scoring software, so don't be surprised if you discover that the credit scores they generate for you are different.

Why are credit scores sometimes called FICO scores?

The software used to calculate a great number of credit scores were created by Fair Isaac Corporation--FICO.

Which parts of a credit history are most important?

The percentages below shows a breakdown of the *approximate* value that each aspect of your credit report adds to a credit score calculation.

Use these percentages as a guide:

- 35% - Your Payment History
- 30% - Amounts You Owe
- 15% - Length of Your Credit History
- 10% - Types of Credit Used
- 10% - New Credit

Your Payment History Includes:

- Number of accounts paid as agreed
- Negative public records or collections
- Delinquent accounts:
 1. total number of past due items
 2. how long you've been past due
 3. how long it's been since you had a past due payment

What You Owe:

- How much you owe on accounts and the types of accounts with balances
- How much of your revolving credit lines you've used--looking for indications you are over-extended
- Amounts you owe on installment loan accounts vs. their original balances--to make sure you are paying them down consistently
- Number of zero balance accounts

Length of Credit History:

- Total length of time tracked by your credit report
- Length of time since accounts were opened
- Time that's passed since the last activity
- The longer your (good) history, the better your scores

Types of Credit:

- Total number of accounts and types of accounts (installment, revolving, mortgage, etc.)
- A mixture of account types usually generates better scores than reports with only numerous revolving accounts (credit cards)

Your New Credit:

- Number of accounts you've recently opened and the proportion of new accounts to total accounts
- Number of recent credit inquiries
- The time that's passed since recent inquiries or newly-opened accounts
- If you've re-established a positive credit history after encountering payment problems
- In general, checking to make sure you aren't attempting to open numerous new accounts

Credit scoring software *only* considers items on your credit report. Lenders typically look at other factors that aren't included in the report, such as income, employment history and the type of credit you are seeking.

What's a *Good* Credit Score?

Credit scores (usually) range from 340 to 850. The higher your score, the less risk a lender believes you will be. As your score climbs, the interest rate you are offered will probably decline.

Borrowers with a credit score over 700 are typically offered more financing options and better interest rates, but don't be discouraged if your scores are lower, because there's a mortgage product for nearly everyone.