

Credit Scores

What's in a Number?

EXCERPTED FROM "THE POWER OF CREDIT SCORES" by Pat Curry • Bankrate.com

Ever wonder why you can go online and be approved for credit within 60 seconds? Or get prequalified for a car without anyone even asking you how much money you make? The answer is credit scoring. Your credit score is a number generated by a mathematical algorithm based on information in your credit report, compared to information on tens of millions of other people. The resulting number is a highly accurate prediction of how likely you are to pay your bills.

If it sounds arcane and unimportant, you couldn't be more wrong. Credit scores are used extensively, and if you've gotten a mortgage, a car loan, a credit card or auto insurance, the rate you received was directly related to your credit score. The higher the number, the better you look to lenders. People with the highest scores get the lowest interest rates.

Scoring Categories

The scale runs from 300 to 850. The vast majority of people will have scores between 600 and 800. A score of 720 or higher will get you the most favorable interest rates on a mortgage, according to data from Fair Isaac Corp., a California-based company that developed the credit score. (Its own score is called the FICO score.)

What's the Big Deal?

Your credit score will determine if you get credit at all, and the interest rate on that credit, says Ed Ojdana, president of *Experian Consumer Direct*, part of Experian, the largest of the three major credit-reporting agencies. "The better the score, the lower the interest rate and that can save you a ton of money." The difference in the interest rates offered to a person with a score of 520 and a person with a 720 score is 3.45 percentage points, according to Fair Isaac's Web site. On a \$100,000, 30-year mortgage, that difference would cost more than \$85,000 extra in interest charges, according to Bankrate.com's mortgage calculator. The difference in the monthly payment alone would be about \$235.

Consumers' rights

Until recently, many Americans didn't even know this number existed because it was a closely guarded secret in the lending industry. In fact, lenders were prohibited from telling borrowers their credit score ... All that changed a few years ago, when consumers began finding out about the score and demanding to see it ... Public outcry on the possibility of people being denied credit based on bad information in credit reports led to several pieces of legislation -- and a much more open attitude about credit scores. Fast forward to current day: Consumers can buy* their score online from any number of sources, including Fair Isaac.

*Recent legislation gives you the right to view your credit report annually for FREE. Just visit the official federal government Web site at <https://www.annualcreditreport.com/cra/index.jsp> to learn more. Be aware, however, that the free report does not provide that critical piece of information, YOUR CREDIT SCORE. As a professional lender, Mortgage Trust has access to both your credit report AND the credit score -- both of which we will share with you.



Credit Scores, Continued ...

Key factors of your score

Just what goes into the score? Everything in your credit report, with different kinds of information carrying differing weights, says Fair Isaac consumer affairs manager Craig Watts. The model looks at more than 20 factors in five categories.

1. How you pay your bills (35 percent of the score) The most important factor is how you've paid your bills in the past, placing the most emphasis on recent activity. Paying all your bills on time is good. Paying them late on a consistent basis is bad. Having accounts that were sent to collections is worse. Declaring bankruptcy is worst.

2. Amount of money you owe and the amount of available credit (30 percent) The second most important area is your outstanding debt -- how much money you owe on credit cards, car loans, mortgages, home equity lines, etc. Also considered is the total amount of credit you have available. If you have 10 credit cards that each have \$10,000 credit limits, that's \$100,000 of available credit. Statistically, people who have a lot of credit available tend to use it, which makes them a less attractive credit risk. "Carrying a lot of debt doesn't necessarily mean you'll have a lower score," Watts says. "It doesn't hurt as much as carrying close to the maximum. People who consistently max out their balances are perceived as riskier. People who never use their credit don't have a track history. People with the highest scores use credit sparingly and keep their balances low."

3. Length of credit history (15 percent) The third factor is the length of your credit history. The longer you've had credit -- particularly if it's with the same credit issuers -- the more points you get.

4. Mix of credit (10 percent) The best scores will have a mix of both revolving credit, such as credit cards, and installment credit, such as mortgages and car loans. "Statistically, consumers with a richer variety of experiences are better credit risks," Watts says. "They know how to handle money."

5. New credit applications (10 percent) The final category is your interest in new credit -- how many credit applications you're filling out. The model compensates for people who are rate shopping for the best mortgage or car loan rates. The only time shopping really hurts your score, Watts says, is when you have previous recent credit stumbles, such as late payments or bills sent to collections. "Then, looking for new credit will be seen as an alarm because statistically, before people declare bankruptcy and default on everything, they look for a life preserver," Watts says. Also, if you have a very young credit file, an inquiry can count for more than if you've had credit for a long time.

What doesn't count in a score: Age, race, job or length of employment at your job, income, education, marital status, whether or not you've been turned down for credit, length of time at your current address, whether you own a home or rent. Though a lender may consider all those factors when deciding whether to approve a loan application, they aren't part of how a FICO score is calculated, Watts says.

Credit scores are not perfect

The major drawback to credit scoring is that it relies on information in your credit report, which is quite likely to contain errors. That's why it's critical that you check your credit reports annually, or at the very least three to six months before planning to buy a house or a car. That will give you sufficient time to correct any errors before a lender pulls your score. Watts says that the need for accuracy in credit files is one reason why it's good for consumers to learn about credit scores. "There's a hope that as consumers know about credit reports and scores, they'll do more to correct errors and provide more oversight," he says. "If consumers can police the accuracy of their own reports, everybody gains."

