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Understand Your Credit Ratings

Perhaps the most important element of obtaining a good rate on your mortgage is your credit history. This section is designed to help you assess your possible credit rating and what type of terms you can expect from a lender.

Mortgage

When you apply for a mortgage loan from a lender, broker or private investor the **most important factor is your credit**. In some cases it is only your credit that determines your ability to obtain a mortgage loan. There are other factors but credit is by far the most critical factor that both determines whether you will get a mortgage loan and at what rate of interest you will get the mortgage loan at. The better your credit rating the better your mortgage loan rate will be.

Before You Go Shopping

If you plan to "shop around" for a mortgage I advise that you take the time to order your credit report from all three credit reporting agencies, and distribute them to the lenders you wish to "shop" with. I advise this because each time a potential lender pulls your credit, your **FICO Score** goes down. In some instances this can mean the difference between qualifying for a conventional mortgage (at good rates) and a non-conventional at rates less favorable.

The three major credit reporting agencies are:

- Experian - PO Box 2104 - Allen, TX 75013 1-800-682-7654
- TransUnion - PO Box 390 - Springfield, PA 1-800-916-8800
- Equifax - PO Box 105873 - Atlanta, GA 1-800-685-1111

General Guide to Credit Ratings

This is a general guide to what is called "A-B-C-D" credit. These grades are typical of the requirements used by many lenders, but are not absolute grades. Individual lenders typically have similar but somewhat different specifications. Keep in mind that late payments, called "lates", are generally tracked within the previous 12-month period.

- **"A" Credit**

Considered the best credit rating. **FICO Scores** are generally 620 and up with no lates on mortgage and no more than one 30-days-late on revolving or installment credit. No bankruptcy within past 2-10 years. Maximum debt ratio is 36-40% while maximum loan-to-value ratio is 95-100%. This type of credit will demand the best interest rate available!

- **"B+" to "B-"**

General good credit with **FICO Scores** from 581 - 619. Two or three 30-days-late on mortgage and two to four 30-days-late on revolving or installment credit. Cannot have any 60 day lates. Must be 2-4 years since bankruptcy discharge. Maximum debt ratio averages 45-50% while maximum loan-to-value ratio is 90-95%. This type of credit will obtain rates 1-2% higher than current market rate.

- **"C+" to "C-"**

Fair credit with **FICO Scores** from 551-580. Three to four 30-days-late on mortgage are allowed. Installment or revolving credit can have four to six 30-days-late or two to four 60-days-late. Must have 1-2 years since bankruptcy discharge. Maximum debt ratio runs around 55% with maximum loan-to-value ratio averaging 80-90%. This type of credit will generate rates 3-4% higher than current market.

- **"D+" to "D-"**

Overall poor credit history with **FICO Scores** from 550 and lower. Two to six 30-days-late on mortgage or one to two 60-days-late, with isolated 90 days late. Revolving and installment lates show poor payment record with pattern of late payments. Possible current bankruptcy or foreclosure allowed with all unpaid judgments to be paid with loan proceeds. Must have stable employment. Maximum debt ratio averages 60% with max loan-to-value of 70-80%. This type of credit will result in high interest rates (12-14%), but borrower can always refinance after one year of "on-time" mortgage payments to bring rate down.

Please keep in mind these are "general" guidelines. Some lenders assign different grades or use different grade definitions based upon their own method of evaluation.

Always remember to check your credit report for errors once a year! It is estimated that 50% of all credit reports contain errors significant enough for an individual to be denied a loan!

What is a FICO Score?

A FICO score is a credit score developed by Fair Isaac & Co. Credit scoring is a method of determining the likelihood that credit users will pay their bills. Fair, Isaac began its pioneering work with credit scoring in the late 1950s and, since then, scoring has become widely accepted by lenders as a reliable means of credit evaluation. A credit score attempts to condense a borrowers credit history into a single number. Fair, Isaac & Co. and the credit bureaus do not reveal how these scores are computed. The Federal Trade Commission has ruled this to be acceptable.

Credit scores are calculated by using scoring models and mathematical tables that assign points for different pieces of information which best predict future credit performance. Developing these models involves studying how thousands, even millions, of people have used credit. Score-model developers find predictive factors in the data that have proven to indicate future credit performance. Models can be developed from different sources of data. Credit-bureau models are developed from information in consumer credit-bureau reports.

Credit scores analyze a borrower's credit history considering numerous factors such as:

- Late payments
- The amount of time credit has been established
- The amount of credit used versus the amount of credit available
- Length of time at present residence
- Employment history
- Negative credit information such as bankruptcies, charge-offs, collections, etc.

There are really three FICO scores computed by data provided by each of the three bureaus—Experian, Trans Union and Equifax. Some lenders use one of these three scores, while other lenders may use the middle score.

Frequently Asked Questions (FAQs)

How can I increase my score? While it is difficult to increase your score over the short run, here are some tips to increase your score over a period of time.

- Pay your bills on time. Late payments and collections can have a serious impact on your score.
- Do not apply for credit frequently. Having a large number of inquiries on your credit report can worsen your score.
- Reduce your credit-card balances. If you are "maxed" out on your credit cards, this will affect your credit score negatively.
- If you have limited credit, obtain additional credit. Not having sufficient credit can negatively impact your score.

What if there is an error on my credit report? If you see an error on your report, report it to the credit bureau. The three major bureaus in the U.S., Equifax (1-800-685-1111), Trans Union (1-800-916-8800) and Experian (1-888-397-3742) all have procedures for correcting information promptly. Alternatively, your mortgage company may help you correct this problem as well.