

HOW TO RAISE YOUR CREDIT SCORE

What is a Credit Score? It is a three digit number between 400 and 900 where the higher the number is, the better your score or “grade”. Virtually all lenders now use scores to make lending decisions.

Unfortunately, your credit score will be different depending on what type of lender you seek. For example, if you go a car dealer, a credit card company, or a mortgage lender, each may receive a different score for you when they “pull” your credit.

To make it simple, just know that the score we mortgage lenders pull will be about 20 points lower than the score you get from most other sources (including the Credit Bureaus!). Many consumers think their credit score has dropped when we qualify them but, in fact, this issue is the only difference.

Next, if a lender pulls your credit, 30 days later, your score will go down a few points. If several lenders in the same business pull your credit within a 30 day period, it will only count as one “hit”. For example if you shop for an automobile, several car finance companies may pull your credit, but it should only count a one.

The website I recommend to check your credit is www.myfico.com . According to experts, this is the only place you can see your “mortgage” score. Equifax and Transunion are available, Experian is not. There is no way that I know of to see your Experian “Mortgage” score unless a lender pulls it. This will then lower your score 30 days later as I mentioned.

In the mortgage business, we pull all three and then we “use” is the middle one of the three. For example, if your scores are 640, 621, 666, then we would use 640. If more than one person is on the mortgage loan, we “use” the score for the person that has the lowest middle score.

If you're sure your credit is good or great and you just want to make it better, a few simple concepts are all you need to know:

- Paying Off Debts will raise your score (the most obvious of all)
- Obtaining or Keeping at least two Credit Cards is critical.
- Keeping the balance(s) on credit cards very low will raise your score
- Keeping credit cards active is important. (Use them at least once every 6 months)
- Do not use Finance Companies. If their name ends with “Finance” avoid them.
- Avoid Department Store Credit Cards if possible.
- Follow up with anyone that claims you owe them money. Keep records. Knowing you are right is not good enough, you need to be able to prove it.

Let's devote the rest of this article to those whose credit is not good and want to improve to be able to buy a home:

Simply put: *“paying off old “bad” debts will not raise your credit score, it will just keep it from going down in the future. Good management of current “good” debts will raise your credit score.”*

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So, let's get to main question—what credit score does one need to get a mortgage loan?

- **VA is minimum 620**
- **FHA is minimum 640**
- **Conventional is minimum 680, unless you put 20% down, then minimum 620.**

These requirements are the same for most lenders across the industry. Some lenders require even higher scores. Be prepared for a very difficult, if not impossible, loan process if you are promised a loan and your score is below those stated above.

Having a credit score high enough allows you to proceed to the next step. It does not mean your loan will be approved. For example, In the case of a prior bankruptcy or foreclosure, you must not only have a credit score as stated above, but also must meet other requirements such as mandatory waiting periods. Also, your debt ratio is critical.

How can I raise my credit score and how long will it take?

Clearing up old, derogatory credit issues will not raise your credit scores, it will just keep them from possibly going down in the future. Good management of current, “good debt” is how you raise your score.

Good debts are those accounts where on time payments going forward will report positive payment history to the credit bureaus. Examples are credit cards, car loans, mortgages, etc. If you get more than 30 days behind on a good debt, your score will decrease, however, the lender will usually allow you to catch up and as you pay on time again month after month, your score will increase. In most cases, your score will increase some just for bringing it current. If you get far enough behind, though, the lender will eventually change your status permanently to a “bad debt”.

Bad debts are *Collection Accounts, Charge-Offs, Judgments, Liens, or Foreclosures*. If you have any of these on your report, your score will be lower. The older they are, the less they affect you.

When the lender on a good debt that has become delinquent reaches the point where they no longer want to keep your account, they will usually “sell” the debt to a collection agency resulting in a “collection account”. Once a debt becomes bad, the lender will generally not allow you to “catch up” and resume normal status. They will then insist you deal with the collection agency only. At this point the debt is derogatory permanently and will have a bad effect on your credit score. If it is paid soon after, it should stop having a negative impact. If it remains unpaid, the negative impact will fade slowly over time.

Largely unseen these days are “charge-offs”. This is where the lender just gives up trying to collect the debt. Collection agencies have become so prevalent that if the lender no longer wants to pursue collection they can just sell it to a collection agency, so there is no reason for the lender to give up completely.

Collection accounts or Charge-offs can also result from accounts that were never good credit references to begin with such as medical bills. They don’t appear on the credit report unless they are delinquent. This will usually result in only one derogatory reference.

Judgments and Liens are entered in a different place on the credit report called “public records”. They generally “hit” your score a little harder. Because they involve a creditor/taxing authority and the county record-keeping department, clearing them involves twice as much work. Unlike collection Accounts and Charge-offs, loan approval almost always requires resolving/paying these items. .

Regardless of whether a bad debt has been paid, once the date of last activity fades into the past (1 to 2 years) the debt does not affect your score nearly as much. Get ready for this—paying a collection account that is several years old will lower your credit score temporarily because the date of last activity has now become current and it is a bad debt! At least once it’s done, you should never have to deal with it again. So, you may actually want to defer paying old items until you’ve accomplished getting your home, then deal with them

After 7 years (10 for public records), debts are supposed be deemed old and drop off your report.

The problem is old bad debts left unresolved can come back to bite you. One collection agency may tire of trying to collect or realize the date of last activity is nearing seven years and “sell” the debt to another collection agency. They, in turn, create a new entry on your credit report and attempt to make an “old” debt appear “new”. It a trick, but it is very difficult to fight. For this reason, paying old bad debts is usually better than trying wait until seven years.

Automobile repossessions are particularly tricky. The main problem is there is usually a large balance remaining. That means collection agencies are more likely to “keep it active” and cause you problems. Generally, if you signed papers when the auto was taken, you agreed to the “amount owed” that will show

on your credit report. If you didn't sign papers when the auto was taken, the lender may have to, by law, account for the "amount still owed" that will show on your credit report. Getting on a payment plan, or negotiating a settlement is usually a good idea when it comes to a repossession.

State laws exist that declare debts older than a certain age "uncollectable" so lenders are supposed to stop pursuing them. Once again, the problem is fighting the collection agencies is extremely difficult, if not impossible.

Now that we've covered how to clean up the issues from the past, let's talk about creating new, good credit. The fastest, easiest way is called a "secured" credit card. You give the lender the requested small amount of money, say, three hundred dollars. They put it in a savings account with a freeze on it and issue you a Mastercard or Visa for the same amount. If you default, they keep your money. Because there is no risk the lenders will usually give this card to anyone. It's the perfect way to rebuild credit.

Installment accounts such as car loans, etc, will build your credit, but more slowly.

Stay away from finance companies, if possible. If the name of the institution has the word "finance" at the end, they are a finance company. They have higher interest rates and can actually make your credit score lower than dealing with banks. Department stores, likewise, will not help your credit score as much as Mastercard, Visa, Discover, etc.

Also, American Express, issues two types of cards—one that requires you to pay in full every month and one that allows you to run a balance like most cards. The first one will not improve your credit score, the second will.

Another way we've seen credit improve is by having a relative or spouse add you to their card as an authorized user. This makes the entire history of that card apply to your credit. The credit bureaus may not continue to do this, but for now it may help you.

Now that we've examined credit at it relates to obtaining a mortgage, let do a quick review.

- Credit scores between from 620 and up are generally needed to get a mortgage loan, depending on the loan program.
- "Cleaning up" derogatory credit is important to keep your score from being lowered going forward. (With the possible exception of small, older accounts)
- Creating new, positive credit is the key to raising your credit score.
- Use www.myfico.com to see the correct score, all other sites may not be correct for our purpose.
- Learn the terms listed above to be educated and protect your credit score in the future

I hope this information helps on the road to home ownership!

John

Glossary of Terms: Know these terms to help protect your credit.

- Credit Bureaus—these are the companies that store your credit history. There are three: Equifax, Transunion, and Experian
- Judgment—the lender has gone to court and the court rules against you. The court then reports to the Credit Bureaus.
- Garnishment—the local court has ordered your employer to withhold money from your paycheck to recover the debt.
- Lien—the court issues an order that ties up any real property you have from being sold transferred or borrowed against.
- Chapter 13 Bankruptcy—the court tells all creditors to stop contacting you, interest charges stop, and you pay the balance owed in regular installments over a period of time (years)
- Chapter 7 Bankruptcy—the court wipes out all previous debt except for federal debt (student loans, etc) and you start fresh.
- Chapter 11 Bankruptcy—a business bankruptcy
- Public Records—all the above court-related delinquent credit that is written on a separate section of your credit report and are generally more serious.
- Past Due Account—for our purposes here an account that is behind but that can be brought current.
- Collection Account—an account that has been placed on your credit report by collection agency and is permanently bad until it is paid.
- Charge Off—An account where the lender reporting to the credit bureaus has stopped trying to collect.
- Over 30—at least 31 days past the due date without proper payment
- Over 60—at least 61 days past the due date without proper payment
- Over 90—at least 91 days past the due date without proper payment
- Voluntary Repossession—a vehicle it returned to the lender and the person obligated on the loan signs paperwork
- Involuntary Repossession—a vehicle is taken by the lender and no paperwork is signed
- VA loan—a loan program available to active duty military or prior military requires zero down payment
- FHA loan—a loan program that is available to all consumers in most situations and requires only 3.5% down payment.
- Conventional loan—loan programs other than FHA and VA that requires minimum 5% down.
- Debt Ratio—a percentage of your proposed total debt versus your gross income. Reflects your ability to make the mortgage payment