AN OVERVIEW OF CREDIT BASICS

By Joseph Kershenbaum

Your credit history is an important factor in your ability to borrow money. Lenders will review your credit to determine if it is a good risk for them to make you a loan. A lender wants to be sure that if it lends you money, you will repay it on time.

Credit, however, is only one factor in a lender's decision to make a mortgage loan. A lender also considers other factors that include your income and employment history, your monthly debts and assets, the down payment amount, the type of loan you are seeking and the property and its value. Nonetheless, if you want to buy or refinance a home, investment or commercial property, it's a good idea to understand how credit can affect you.

Different industries, such as the automobile and furniture businesses, use distinct types of credit reports applicable to their trades. In this article, I will answer the most common questions we hear about credit regarding getting a mortgage loan to purchase or refinance real estate.

What is a credit report and how does it affect your loan?

A credit report is a record of how you manage your personal finances. It contains a chronological account of the money borrowed to purchase goods and services and the history of paying that money back. A credit report contains four main sections:

- **Identification:** Identification includes personal information such as name, address, former names and addresses, social security number and date of birth.

- **Trade Lines:** A trade line is a credit account established with a lender or other organization offering credit, such as a utility company. They each report the account type, the date the account opened (and, if applicable, the date it closed or the loan was repaid in full), the credit limit or loan amount, the remaining balance, the payment history and the lender contact information. Trade lines can include mortgages, lines of credit, installment loans such as auto or student loans, credit cards and utility payments.

- **Inquiries:** Inquiries include a list of every company that has ordered your credit report for the prior two years.

- **Public Records and Collections:** Public record information is collected from state and county courts. This information may include bankruptcies, foreclosures, liens, judgments, lawsuits and wage garnishments. Collection agency information is collected on overdue debt on which payment has stopped.

If a lender makes a loan — whether for a mortgage, line of credit, credit card, installment or other type of loan — a risk exists that the borrower might not pay back the loan or pay it back on time. If so, it can be costly for the lender.

Lenders set loan terms and interest rates based on market factors and their estimation of the borrower's ability to pay back the loan. They will review your credit report to help them quantify that risk and predict whether you will repay the loan on time. Having good credit typically means that you pay your bills on time and haven't borrowed too much money so that you might have financial difficulties in the future. If you have good credit, you may have a wider range of loan options, and may receive better terms and lower interest rates.

If you have problems with your credit, it may be harder to get a loan on the terms you want. The interest rate may be higher to compensate the lender for the risk of lending you money.

What are credit scores?

Three national credit reporting agencies, Equifax, Experian and TransUnion, collect your credit information from creditors and sell it to lenders who want to review your credit history. Each of those three credit agencies keeps a file on you and each calculates a credit score. Mortgage lenders generally merge the three scores into a single credit report.

Your credit score is a number that helps lenders determine how likely you are to repay a loan. Specifically, a mortgage credit score is designed to predict the likelihood that you will be 90 days late on your payment within the next two years.

The higher your score is, the better that risk is. Your credit score is composed of a number of key factors, but no one category is determinate. Its importance depends on the overall information contained in your credit report. The key factors include:

- **Payment history:** This accounts for about 35% of your score. Recent payments carry great weight than more distant ones.

- **Amount of debt owed:** This accounts for about 30% of your score. Items such as credit cards near their limits or consolidating debts onto fewer credit cards both can lower your score. Your score will be higher if you have more credit cards with low balances than a small number of cards close to their limits.

- **Length of credit history:** This accounts for about 15% of your score. Your score will improve if you have a history of regularly paying your bills on time and keeping your credit card balances low relative to their limits.

- **Types of credit used:** This accounts for about 10% of your score.

- **Pursuit of new credit:** This accounts for about 10% of your score. This includes the credit inquiries, reestablishment of positive credit following payment problems and the number of recently opened accounts. For example, if you have applied for several credit cards recently, your score can decline although typically, these are treated as a single inquiry and will have little impact.

Does ordering a credit report affect my score?

Ordering your credit to apply for a mortgage loan has a minimal, if any, affect on your credit score. Most credit scores are not affected by multiple mortgage loan inquiries with a short period of time.

If, within the past 365 days, you ask one or more mortgage brokers or lenders to order your credit report, the inquiries are ignored for scoring purposes for the first 30 calendar days. For inquiries older than 30 days, all inquiries made within a period ranging from 14-45 days are counted as just one inquiry.

According to Fair Isaac Corp., which develops credit scoring models used by creditors, including mortgage lenders, inquiries are the least significant factor considered. They state that, "Much more important is how you pay your bills and how much you owe."

Scores typically distinguish between a search for a single loan and one for many new, different credit lines. The net result is that ordering your credit to apply for a mortgage typically will have little or no effect on your credit score.

How can I establish credit?

We all start with no credit history and some of us have yet to establish credit, but want to purchase real estate. Many mortgage brokers can arrange loans for those with no credit scores and have programs for those with alternate trade lines that don't appear on your credit report.

You'll have more loan options, however, if you have an established credit history. To earn a credit score, your credit report must include, at a minimum, one account that has been open for at least six months, and one account that has been updated within the past six months. If you do not meet these thresholds, you can begin establishing credit in a number of different ways.

To start, opening a checking or savings account can help you build credit. Saving money, making regular deposits and writing checks only when you have the funds to pay for things provides a simple way to start managing your personal finances. You can pay bills and track your expenses.

If you have utility services in your name, such as telephone, cell phone, gas or electric, pay them in full and on time. If you're renting, pay your rent in full and on time.

If you have any loans or credit cards, pay them on time each month, even if you only pay the minimum amount due. If you borrow on credit, don't borrow more than you can afford to pay.

If you don't have a credit card, applying for one and using it in a responsible way can help establish good credit. If you are unable to get a regular credit card, you may wish to apply for a secured credit card. With a secured card, you pay a pre-set sum into an account upfront, then use it like a regular credit card until you drawn down the balance.

If you have credit cards and installment loans, and manage your credit responsibly by paying your bills on time, you will have more loan options than someone who uses only cash.

How can I maintain my good credit?

To maintain good credit, pay your bills on time, pay at least the minimum amount required on your debts and keep your credit card balances low relative to your ability to pay them. In other words, don't take on debt that you can't afford to repay.

How can I improve or repair my credit?

Credit problems in the past can affect your present credit history. Late payments can remain on your credit report for up to 7 years from the date the original payment was due. Bankruptcies can remain for up to 10 years.

However, there are many ways to improve and repair your credit and raise your credit score. No credit score is written in stone. Your credit report and your score can be affected every time that you apply make (or don't make) a payment or apply for a credit card or a loan.

A number of ways exist for you to improve or restore your credit:

- **Set a budget:** Managing your personal finances is the first step building better credit. Set and budget and keep to it. Separate what you want from what you need. Don't spend money if you don't have it. If you can, save a little bit each month.

- **Pay your bills on time:** Late payments have a major impact on your credit score. Even if you can make only minimum payments, doing so will begin to improve your credit. If you've missed payments, begin paying them on time, as your credit score will improve the longer you do so.

- **Keep balances low on credit cards and revolving credit accounts:** A key factor is your score is that revolving credit balances are low relative to the credit limits on the card. Don't close credit card accounts, but pay the balances down.

- **Don't open new accounts just to have additional credit:** Open new accounts only as needed and make payments on time.

- **Pay off your debt instead of moving it to another account.**

- **Contact creditors if necessary:** If you're having trouble making payments, contact your creditor to work out a plan instead of ignoring the debt.

- **Check your credit report:** Mistakes in your credit report can lower your score. Check it and correct any errors that occur.

- **Act now:** The sooner you begin, the sooner your credit score will improve.

How can I correct errors in my credit report?

Errors in your credit report can impact your score. Credit agencies may not always have up-to-date or accurate information. Further, if you have negative credit information, such as credit or collection accounts or judgments, older than 7 years old, or bankruptcy information older than 10 years old, you can have it removed from your credit report.

To dispute information in your credit report:

- Write a clear letter explaining why you're disputing it to the credit agency or agencies listing the information and to any relevant creditors. Include documentation you have to support your claim. It can be a good idea to send it by certified mail, so you have a record that it was mailed and received.

- Keep copies of your letters and supporting documentation.

- Make sure you get written verification from the credit agency and/or creditor that the change has been made. Creditors and credit agencies must investigate a dispute and respond to you within a reasonable time.

- You may also add a personal statement to your correct report if it's related to incorrect information.

The contact information for the three major credit agencies is:

Equifax Disputes	Experian Disputes	TransUnion Disputes
P.O. Box 740241	P.O. Box 2002	2 Baldwin Place, P.O. Box 1000
Atlanta, GA 30374	Allen, TX 75013-0036	Chester, PA 19022

Tel: 800-685-1111 Tel: 888-397-3742 Tel: 800-888-4213

Conclusion

By understanding the basics of how credit works regarding the purchase or refinance of real estate, you can improve your ability to qualify for a larger mortgage loan at better rates and terms. You also will gain the advantage of having more options for different types of loans that you may prefer based on your particular needs. In short, properly managing your credit means that you gain control of an important factor when you want to purchase or refinance real estate, and thus, put yourself in a better position when you apply for a loan.

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