The Importance of Your Credit Score

A strong credit score is key to getting a favorable interest rate on your home mortgage. Read on to find out more about what goes into determining your credit score and most importantly, some simple steps you can take to improve your score. It is wise to talk to a lender about more complex options for improving your score, since there are so many different factors that affect your credit score.

Why is a credit score important?

Your credit score plays an important role in getting a good loan. If you have a good credit score, you have more loan options available to you and you will generally be able to obtain a lower interest rate, potentially saving you thousands of dollars over the life of the loan.

What is a credit score?

Your credit score is a number attached to your credit report that reflects the likelihood that you will repay your debt, based on your credit history and current credit status. The most common credit score used by lenders is the FICO score, which ranges from 300 – 850. FICO is an acronym for Fair Isaac Corporation and refers to their proprietary credit scoring system which is calculated using mathematical formulae. A FICO or credit score is not an indicator of wealth, but rather a tool used by banks and lending institutions to determine credit worthiness.

There are three credit reporting agencies. Your score will vary somewhat among these agencies. When you are applying for a mortgage loan, a lender will pull reports from all three bureaus, called a tri-merged report and will use your middle score (not the average score).

How is a credit score determined?

A FICO score takes into account information from all of the following categories. The relative importance of any one factor depends on the overall information in your credit report.

Payment History – 35% A consistent record of making your payments on time helps your score. Late payments will hurt your credit score. Payment history takes the following into account:

- Credit account payment information
- Presence of adverse public records – bankruptcy, judgments, collections, liens
- Severity of delinquencies – length of time past due
- Number of past due items
- Number of accounts paid on time

Amounts Owed – 30% This factor takes into account what you owe on all your accounts, the number of accounts with balances and how much of your available credit you have used. The more you owe as a percentage of your credit limit, the lower your score will be.

Length of Credit History – 15% A longer credit history will increase your credit score. Therefore, it is not generally a good idea to close accounts you no longer use; by doing so, you may be eliminating a good percentage of your credit history.

New Credit – Recent Inquires – 10% Several hard inquiries from a lender or business will decrease your credit score. Opening new accounts can lower your score.

Types of Credit Used – 10% The score takes into account your mix of credit cards, retail accounts, installment loans, finance company accounts and mortgage loans. Although credit mix is not a large component of your score, it becomes more important if you do not have a lot of other information on which to base a score.

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Boosting Your Credit Score

Since your credit score is an indication of your credit risk based on a snapshot of your credit history, your credit score is not a static number – it is dynamic and changes as your information changes at the credit reporting agency. If you have had poor credit in the past, you can improve your score by managing your credit responsibly. Recent good credit management has a more significant bearing on your credit score than the negative impact of past credit problems, since their impact will diminish as time passes. Establishing or re-establishing a good track record of making payments on time will raise your credit score. The following are some dos and don'ts to improve your credit score:

Do's and Don'ts

- Do pay all your bills on time each month – late payments and collections have a significant negative impact on your credit score. Pay at least the minimum payment by the due date on all your credit cards.
- Do pay down debt. Do check with your lender to determine which debt you should pay down first.
- Do check your credit report periodically to make sure there are no errors or that you are not a victim of identity theft. It is recommended that you review your credit report from each reporting agency at least once a year. (this is a soft inquiry and you checking your credit has no negative impact on your score)
- Do have credit cards, but manage them responsibly. In general, having credit cards and installment loans, and making timely payments on them, will raise your credit score.
- Don't max out your credit cards – if you are going to carry a balance on your credit cards, make sure it is a low percentage of the credit limit on the card.
- Don't cancel your credit cards – unless you are being charged an annual fee. Closing an account will have a negative impact on your score.
- Don't apply for and open new credit accounts frequently. (Don't open up an account with each retailer that promises to give you 15-20% off your purchases the day you open an account with them. That might be a good strategy when you are purchasing a big ticket item, such as an appliance. However, be careful how frequently you are opening up new credit accounts).

Checking Your Credit

You are entitled to receive a free copy of your credit report once a year from each of the three consumer credit reporting companies: Equifax, Experian and Transunion. (There is a charge if you want to receive your credit score.) AnnualCreditReport.com is the official site to help consumers obtain their free credit report. The site cautions you to be aware of how you arrive at the site. To ensure that you are visiting the legitimate site, type https://www.annualcreditreport.com directly into the address bar on your browser. You will never receive an email directly from the Annual Credit Report Request Service.