

# MORTGAGE advisor™

● ISSUE 24

## GIVE YOURSELF CREDIT

Your Credit Score Could be a Reflection of Your Future



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Now, more than ever, your credit score can be your greatest asset or your greatest enemy when it comes to your future quality of life. From credit card interest rates and insurance premiums to loan approvals, banks have become very picky about who they lend to and at what rate. But building and maintaining your credit record is not as easy as just paying bills on time – although that is important too.

For insight into the mysterious world of credit reporting, we asked Dave Muti, author of “Mortgages: What You Need to Know” how that three-digit number is calculated and tips for pumping it up.



The most common credit score used today is the FICO score, created by the Fair Isaac Corporation. It can range from a low of 350 to a high of 850. The higher the score, the lower the interest rate you will be offered, potentially saving you hundreds if not thousands of dollars a year. The magic number to remain above is 720. About half of the country maintains a score above this number. As you

begin to move below 720, interest rates may begin to rise. Fall below 500 and you may not be able to take out a mortgage even if you currently have one.

“Although it seems credit scoring should be an exact science, knowing what affects each component it is more of an art form,” Muti explains. The formulas are proprietary to each of the agencies that rate your credit – Equifax/Beacon, Transunion and Experian. While we do not know the exact formulas, following is what we do know.

### Five Critical Credit Criteria

#### 1. Payment History

Your track record for paying your bills makes up 35% of your score. The largest factor is “paying your bills on time”. While it is best to always pay your bills on or before the date that they are due, paying a bill a few days late and incurring a late charge will not necessarily go on your credit report. Having a “late” on your credit report means that specific account is 30 days or more past its due date. The more “lates” you have, the lower your score will go. If you have a bill that is 60, 90 or even 120 days late, your score will rapidly decrease.

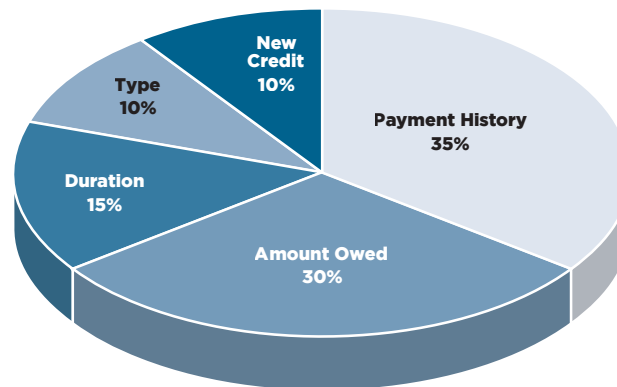
If you already have a “late” on your report, the more time that elapses between the date you were late and the present date the more your score will improve. The mortgage industry has two major thresholds when looking at any late payments on your report – 12 months, and 24 months. Each milestone will provide you with better financing solutions as your late payments fade with time. In addition, a mortgage “late” is much more serious than a credit card “late”. So if it comes down to a choice of “which bill should you pay?” always choose your mortgage payment and never miss paying this one.

## 2. Credit Ratio

How much you owe is 30% of the score. You might think that if you owe less you will have a better score. Unfortunately that is not always true. This portion of your score is determined by a delicate 3-way dance between your types of credit (mortgage, car loans and credit cards), how much you owe, and how much you have available to you. Having too many credit cards can be a negative and so can having only one. Having a credit card with a large limit can be a good thing, as long as you are not near that limit. The same rule applies with a second mortgage or a home equity line of credit. When you have lots of credit available you want to make sure you “use” that credit but do not maintain a high balance. The closer your balance is to the maximum credit available to you, the lower your score will go.

**“79% of all credit reports contain some type of error.”**

~ National Association of State Public Interest Research Groups



## 3. Credit Type

The type of accounts you have makes up 10 % of the score. How much you owe (See #2) combined with what types of credit you have available make up the “art” side of the calculation.

## 4. Credit Maturity

How long you have maintained your individual credit accounts is another 15% of your score. Of course the longer you have had credit, the longer your track record will be, but another important factor is how long you have had a particular account. The longer a particular account is open and active the better your score will be, assuming of course no lates on that account.

## 5. New Credit

Your recent history makes up 10% of your score. Opening up a bunch of new accounts and playing the credit card “balance-switching” game does not look good to the agencies.

Muti notes that income, savings, age, race, geographic location or marital status are not considered in the calculations. “Basically, the score indicates your track record of making payments to companies you owe money.”

## Maintain Your Numbers

Now you know what a FICO score is and how it is calculated so the big question is: how do you maintain it?

As the saying goes, most people don’t plan to fail, they simply fail to plan. All too often, a potential homebuyer looks at houses, makes an offer and then is turned down at the last minute for an affordable mortgage because of an error on the FICO report. According to the National Association of State Public Interest Research Groups, 79% of all credit reports contain some type of error.

Muti’s suggestion is to plan ahead for this event. The same holds true if you are thinking about refinancing. Improving your credit score is kind of like getting ready to run a marathon. You can’t just sign up today and expect to run tomorrow.

If you have a poor credit history or if there is inaccurate information on your report, it can take months to repair and correct. Being proactive with your credit scores (like with many other areas of your life) will improve the results and your experiences.

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If you would like to read more in-depth about what information you need to take control of your finances simply go to [www.MyFICO.com](http://www.MyFICO.com) and download a free 20-page booklet entitled “Understanding Your FICO Score”. They also have a paid service to alert you anytime there is a change to your score and/or credit history. In today’s world of stolen identity this could prove to be a prudent investment. Not only will you save money by ensuring you have good credit, but you may be able to prevent any fraudulent charges against your name as well as the accruing interest and legal fees should you become a victim. You can also obtain a free credit report from [www.annualcreditreport.com](http://www.annualcreditreport.com), or visit [www.lifelock.com](http://www.lifelock.com) for a service that guarantees your good name and credit. Muti’s book “Mortgages: What You Need to Know” is available at [www.pocketguidepress.com](http://www.pocketguidepress.com).

Remember — Make Life Happen! Monitor your credit twice a year. You will be happy you did.



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