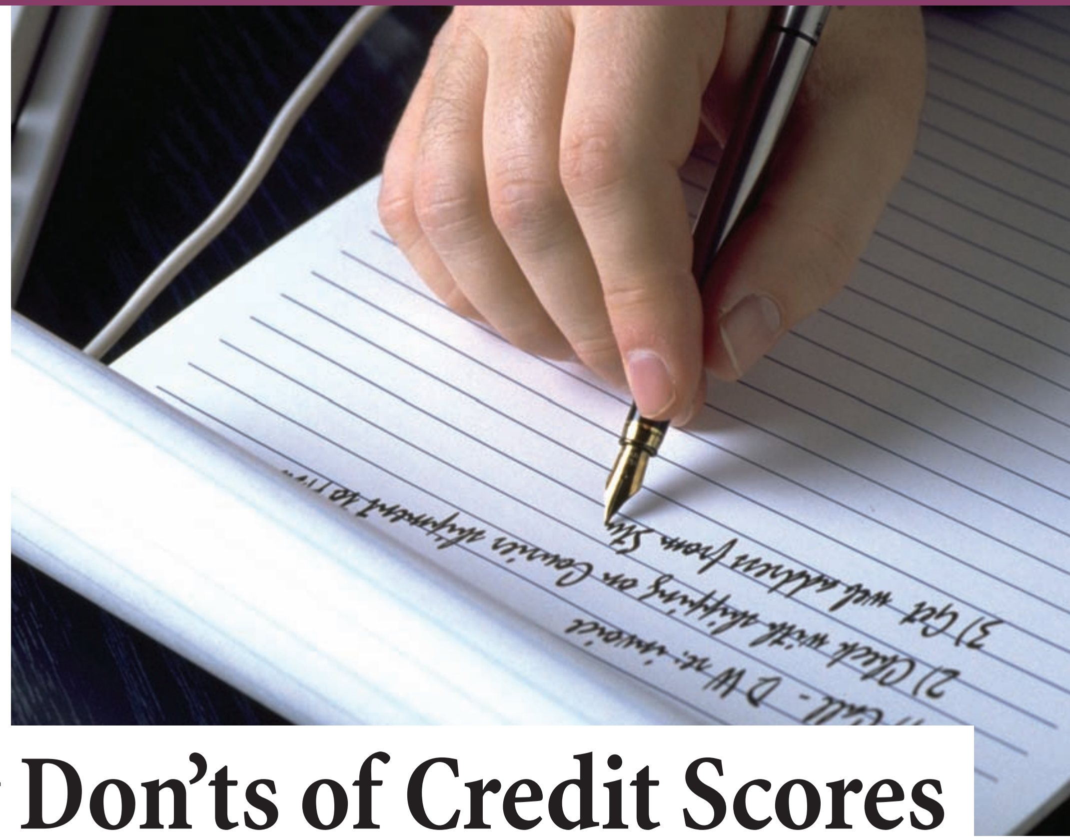

The Do's & Don'ts of Credit Scores

When getting ready for your next home purchase | By Amy Bonis

When applying for a mortgage loan, a lot of folks are very focused on their credit scores. You should be. Your score will determine the down payment, loan program, and interest rate you are able to obtain. Credit scores are designed to evaluate risk and are being used in many arenas including what you will pay for your homeowner's insurance. Some employers even use them in their screening process of applicants.

There are basically three types of credit folks. Those with great credit, those that need to work on their credit, and those in between (mid 600 scores). Credit scores range from about 350 to 850. Bankers look at the middle of three scores. The lowest score we have actually approved on our team was from a client with a score in the 400's. Credit scores that are in the 720 to 740 range are considered outstanding. Some borrowers come into our office when applying for a mortgage loan; they have a high 700 score and get caught up in why their credit score is not higher. They don't realize that even if the score is higher, it will not result in a better term/better rate loan. However, higher scores do typically require less documentation and sometimes very little income.

What we typically see are clients that could potentially have improved their scores if they had started the preapproval process prior to buying a home. Amy Bonis highly recommends meeting with your lender in person and going through the process of getting preapproved prior to making an offer. Getting preapproved is the real thing and requires you to show your income, assets and other documentation which is not needed to get prequalified. Getting preapproved will forewarn you in the event there is an error or a problem with your credit report. It will also allow you the time to fix any problems that may appear on your report. This could help earn you a lower down payment and better interest rate on your loan. A preapproval, if done properly, should not cost you any money and will last about a year. Amy Bonis states "Credit scores do not change in a moment's time but can take a good 60 days to see significant improvements. That is why a preapproval is so important." The same holds true if you are buying an investment property or vacation home. We can really help give advice to our clients that can make the difference between getting a loan (or a better loan) or not!

Here are some tips when preparing to buy or refinance your home:

- Consider putting zero or no money down in lieu of paying off debt. This results in a higher mortgage but allows borrowers to replace non tax deductible debt. Another reason to pay down debt and put less money down is that your credit score may go up. Reducing balances below 35% of the limits can improve credit scores significantly. This is termed your balance to limit ratio and accounts for about 30% of your credit scores.
- Avoid consolidating balances onto one card for the above reason. Paying down debt is sometimes a better strategy than moving it around. Owing the same amount but having fewer open accounts may actually lower your score.
- Do not close credit card accounts without speaking with your Certified Mortgage Planner first! Closing accounts with a long history can adversely affect your credit scores by having your credit history appear shorter. We have seen credit scores drop 100 points in 4 to 6 weeks when they attempt to "fix" their credit. In reality, they are causing their scores to go down. Also, paying off a collection account can sometimes "reactivate" something in the scoring model and cause your score to go down! Paying off a collection account does not remove it from your credit but does give a zero balance. Make sure you discuss any questions or strategies with your Mortgage planner during the preapproval process. You obviously want to avoid harming your score inadvertently.
- Try not to open any new credit prior to getting preapproved for a home loan. Opening up new accounts or a few new accounts in a short time will lower your average age of accounts which will affect your score especially with limited credit information. On the other hand, sometimes opening up one new account is actually "needed" to improve your score. To confirm this, ask your Mortgage Planner to perform a credit simulation on your behalf. Think of a credit simulator like a flight simulator. At Alera Financial in Raleigh, we are able to put data into our simulation systems and in turn, we get information on the probability that if you do "X" by paying down a balance or increasing a credit line, your credit score will move by "Y" points in the next 30 days. Credit simulations are wonderful tools and are great to use ahead of a home purchase (during the preapproval process is ideal). We use them all the time when we meet with our clients on personalized credit enhancing strategies that help make their financial dreams come true.

We had a client who had a score that was good but not great. She wanted a 30 year interest only loan. Her philosophy was that she would take the difference between a traditional mortgage payment and her new (and lower) Interest Only payment and then invest this difference every month in a separate asset (savings) account. So rather than following the traditional path, making principle payments to her mortgage company, she is building her net worth over time. The simulator helped us come up with a plan that helped her in obtaining the credit score necessary to get her desired loan product. She decreased her limit to balance ratio on several cards and established a new account that raised her credit scores about 44 points. This decreased her monthly payment by over $200 per month. Credit scoring models are constantly changing. Don't assume you know what to do to improve your score. Consult with your Certified Mortgage Planner. It is amazing how sometimes just a small movement in score can make a big difference (such as being able to get a better interest rate/lower down payment loan). Sometimes improving your credit score is the easiest answer to getting a loan approved!

Don't forget to check your credit report yearly for updates and errors and to protect against identity theft. Consumers are allowed to get a free credit report yearly and pulling this report does not harm your score. If there are workshops in your area, search them out and learn all you can about the home buying or investing process before you go under contract. Improving your knowledge base is exhilarating and the rules of the game are always changing. Work with professionals and develop relationships. Long term reliable advice from your chosen team is invaluable. For more info, contact our website: Amybonis.com ✢

Pictured: Amy Bonis, Certified Mortgage Planner