Shaun Graham
Mortgage Consultant
Office: (770) 279-0222
Cell: (678) 770-6697
Toll free: (800) 344-8788 Ext. 377

WHAT MAKES UP A CREDIT SCORE?

CREDIT SCORING SEMINAR NOTES & HIGHLIGHTS:

- By definition, a credit score indicates the likelihood of a borrower going 90 days late on a future loan.
- Various factors determine a borrower's credit score.
- Each factor carries a certain weight or percentage on what determines a borrower's Credit Score. You can use the following notes to help your customers credit score when on the edge of losing or winning a deal!

A Credit Score can be broken down in the following percentages:

- 35% of the score is based on the borrowers payment history.
  This history is broken into three components:
  1. **Recency** – the length of time that has elapsed since delinquency.
     - If a borrower has a late payment report on their credit report, initially that delinquency will have a very negative affect on the credit score. As the delinquency ages, it will have a lessening negative affect on the score. Use the 3 below categories to gage how severe a recent late payment will affect a credit score
       - 0-6 Months – A very negative affect on the borrower's credit.
       - 7-23 Months- a moderate negative affect on the borrowers credit.
       - 24+ Months –When a delinquency drops out of having a negative affect.
  2. **Frequency** – The frequency of delinquencies.
  3. **Severity-** *How* delinquent a person was: 30,60,90,120 days late etc.

  The combination of these factors together will affect this portion of the credit score. On a close deal you can keep your eye on the recency of a late. If a recency derogatory is on the cusp of one of the 3 recency steps and you are a little short on a credit score, waiting until that late moves to the lesser category and repulling credit should help your borrowers score.
- 15% of the score is determined by the amount of credit history.
  - They are looking at months reviewed or the length of time a borrower has had an account. If a borrower has 4 credit cards that have been opened for 2 years each, the credit score formula sees this as having an 8-year history.
  - Some loan consultants or underwriters will advise borrowers to close their accounts in order to improve a credit score. THIS IS INCORRECT!
  - DO NOT encourage borrowers to close accounts; it will not enhance a score. What it will do is negatively affect the borrowers "Credit History" and drop scores.

Warning: keep in mind that when new revolving accounts are opened they affect the history of other existing credit cards. For example, say a person has 1 credit card that has been open with a 6 year history. That person then opens 2 more credit lines. Now the credit score module sees the three cards as if they have been open for 2 years each!

- ## 30% of a credit score is based on the debt balance versus the high credit limit of each revolving type of trade line.

  ** This is IMPORTANT because we can actually affect this section**

  - There are two thresholds in this category that negatively affect a person's credit score:
    1. 50% debt balance vs. the high credit limit is a moderate negative to the score.
    2. 75% debt balance vs. the high credit limit is a stronger negative to the score.

  *NOW LISTEN…*Debt balances kept below 33% of its high credit limit, as the creditor reports to the repositories, *positively* affect a credit score.****

  - For loans where you are 10-20 points short of where your borrower needs to be for a deal, take a good look at the balances and high credit limits of each revolving account. If several of them are above the 50 or 75 % threshold, find out when the billing cycle ends on each account. When the billing cycle ends, the creditor reports the debt balance (at that time) to the repositories and it will remain reported that way the whole month. If the balances on all the revolving accounts are paid down to under 33% of the high credit limit, you should see an improvement in the customers credit scores.
    (Remember, this section is 30% of 850 possible points in a credit score)

  - Another interesting note in this category is regarding Home Equity Lines:

  There is a certain dollar amount where the credit score formula looks at a Home Equity Line as a revolving account rather than an Installment loan. We are not given an exact number, but we are told that if a person took out a Home Equity Line in the range of $0-$20,000 there is a high chance that the formula will look at a Home Equity Line as a revolving account. We are also told that somewhere in the neighborhood of >$25,000 the credit score formula will look at a Home Equity Line as an Installment loan. This is important because a Revolving account with a debt balance above 50% or 75% will be viewed negatively in a person's credit rating.

- ## 10% of score is determined by types of trades

  The credit score formula likes to see a mix of the types of accounts a person has.

  NOTE: Finance company credit cards are not viewed favorably in the credit score model. Statistics prove that borrowers with finance company credit cards have a higher likelihood of having delinquent payments.

- ## 10% of score is determined by inquiries.

  People can RELAX a bit about getting their credit pulled. 85 points can be earned or lost from inquiries. In addition, the credit score model is only looking for inquiries from the past twelve months and it allows 7-10 inquiries for that twelve- month period. When a score is hit for inquiries, it is hit 5-15 points each. The credit score models have been programmed to recognize mortgage related pulls, knowing that there can be several in a short period. The model has been altered to allow a 30-day buffer for additional of mortgage related inquiries.

OTHER NOTES:

- Every broker has struggled with the loan that involves a divorced borrower whose score is suffering from bills that were supposed to have been paid off by the spouse according to a divorce agree, but were not. Unfortunately, there is nothing that can be done in this situation. The borrower can submit a 100-word explanation of the situation and it will show up on their report, however, this will not affect a score up of down.

- A note on Credit Counseling Services: In the past, FICO frowned upon CCS more and treated it as if it were a BK. Now it has loosened up on it a bit.

- Believe it or not, it worsens a borrower's score when they are advised to pay off old collections. Paying an older collection can **lower the score** by refreshing the "Recency" of a collection. (If it were to have been left unpaid it would have continued to get older and older, thus lessening the negative recency affect.) **If you are in a situation where a collection needs to be paid off before a lender will work a loan, make sure that you have that collection paid at the closing.** That way any re-pulled credit reports before the loan closing will not have the negative affect of refreshing an old collection.

- Remember, the credit score system **is not designed specifically for the mortgage industry.** The factors that affect score do not always make sense. But if you apply some of the information that you have read about what makes a credit score, you may be able to answer many of the strange things you see happen on a credit report.

SUMMING IT UP:

Do you WANT to help improve a borrowers score?

Tell them to…

1. Keep or get their balances below 33% when they are reported to the repository.
2. Increase their revolving credit limits without having their credit score pulled by the creditor. Watch inquiries here, but don't be paranoid about them!
3. Also look at what stage a recent delinquency is in and when it may move to a lesser category.
4. Protect themselves IN ADVANCE from damaged credit resulting from divorce.
5. PAY THEIR BILLS!

Tell them NOT to…

1. Open finance company cards ever.
2. Open any new credit cards before a new loan.
3. Pay off old collections before re-pulling credit.
4. Open small home equity lines.
5. Close credit accounts.

Consumers can obtain a copy of their credit report online at the following websites:

- www.experian.com
- www.transunion.com
- www.equifax.com