

# the Mortgage Bulletin

Week of February 25th, 2008

Sample Company Name  
100 Main Street  
Hometown, CA 00000  
Phone: 123-456-7891  
Alternate: 456-789-1234  
Fax: 789-1011-1213  
pnewman@samplecompany.com  
www.pnewman.com



Paul Newman  
Actor

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## What is your score?

As the subprime debacle continues to work its way through the mortgage industry, one thing is becoming abundantly clear. Credit scores are becoming even more important.

Minimum required scores are being increased for certain loan types, loan to value ratio, and loan amounts. Lenders are moving to a more extensive version of risk based, score driven pricing tiers.

Translation: higher scores get lower rates and vice versa. This trend will continue. Count on it.

Credit scores are affected by a wide variety of factors, many of which are intuitive, but some of which aren't.

It makes sense that Payment History is an important factor. And it is.

But consider this: Payment History makes up 35% of the score, while Amounts Owed makes up 30%. There's not much difference between 35% and 30%.

This means that even if you make every payment on time over many years, your credit score can suffer if the balances on your accounts are near the top of the limit.

It is not possible to quantify the exact impact that balance-to-limits have on individual scores. However, we know that balances above 50% of limits tend to lower scores and balances below 50% tend to raise them.

As regards payment history, late payments do not show up on reports until they are 30 days late. The more recent the delinquency the greater the impact.

Length of credit history accounts for 15% of a score. The longer the history the better, assuming of course that the history is good.

Lack of appreciation for this fact has had some borrowers damage their scores by chasing lower rates on credit cards –

transferring balances from old cards onto new ones and then cancelling the old cards.

Assume a borrower has two old credit cards with \$4,000 balances on each and each has a \$10,000 limit. If that borrower opens a new credit card with a \$10,000 limit, transfers the balances and closes the old card the credit score is damaged in three ways.

First, old (positive) accounts are deleted. Second, a new (negative) account is opened. Third, account balance-to-limit has gone from 40% to 80%.

Taking the above into account, here's what you can do to enhance your scores.

Make all payments on time.

Open as few new accounts as possible.

Keep old accounts with good payment history open. Charge against these old account two or three time a year to keep them active.

Maintain balances that are less than 50% of limits.

Additionally, monitor your credit. Several firms offer credit monitoring and you can find them on the web. The value of these services is that you can detect and correct inaccuracies.

BE AWARE that the scores you get from these firms are NOT the same scores you will get when a report is ordered in connection with a mortgage. Typically they are lower.

The final bit of advice is to consult with your mortgage lender well in advance of the need for a loan. Allow time for credit to be pulled and corrective action (if any) to improve your score to be taken.

Do not be caught off guard and suffer because of an unnecessarily low credit score.



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