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FREE Report: Credit Score Basics

How much home you buy depends largely on your credit score. Using credit scores as a part of processing your mortgage application started in 1995; now all financial institutions rely on it. Your credit score is a calculation that is based on information contained in your credit report. This resulting number allows lenders to objectively and quickly determine if you are a good credit risk and if you are diligent about repaying your loans. Scores range from 300 to 900; as a measuring stick, 720 is considered a good score.

The guru of the credit scoring world is Fair, Isaac and Company, also known as FICO. They have created the most common credit scoring model that is used by the Big 3 credit companies: Equifax, Experian, and Trans Union. Exactly how your score is calculated is secret, but there are five categories that make up your overall score:

Payment History (35%) – Have you paid your bills on time? This rates heavily. Bankruptcies and foreclosures are also considered here.

Amounts Owed (30%) – How much do you owe and how many accounts do you have open? Rising balances, maxed out credit cards, new credit requests and high balances oninstallment loans are red flags.

Length of Credit History (15%) – How long have you had established credit? Starting young and paying off your balances is a bonus.

Types of Credit in Use (10%) – What's your "credit mix?" Using a lot of finance companies with higher interest rates is a negative; so are people with no credit in use, since there is a question of whether one can manage credit responsibly.

New Credit (10%) – Have you done a lot of "credit stuff" recently? Multiple checks on your credit from companies will lower your score. **Tip**: If you're shopping around for the best rates, do it fast and furious. FICO will not penalize you if there's a short period of time that your credit is being checked. For example, mortgage inquiries made in any 14 day period will count as one inquiry.

A Few More Credit Improvement Tips:

1. Don't order furniture, appliances or large purchases during the mortgage process, even if you don't have to pay for several months. The total balance owed will be counted as part of your debt when the loan application is reviewed.

2. Don't open a lot of credit cards at once with the goal of establishing good credit. This lowers the average account age and looks risky.

3. Pay down credit card balances (I know, easy to say, hard to do.....). Your score will go up.

4. Don't do a massive close-out of your credit card accounts. This raises FICO's debt-to-credit ratio, which will lower your score. *Want to close out a few accounts, and wondering which one is best?* Choose the newest accounts; keeping the older accounts increases the average age of overall accounts, which improves your score.

5. Check your credit report yearly to verify that all information is accurate. Identity theft and outright errors are increasingly common, and it can take a while to get such problems cleared up. Unfortunately, being unaware of any issues and finding out as you are waiting to get approved for the loan on your dream home is a really bad time. **An easy way to check on your credit score is to go to myFICO.com**. For a small charge, you can order your own score and a report with complete details.