Credit Scores: Why Should I Care?

It's not just banks and lenders that rely on credit scores to help make important credit decisions. Landlords, employers, insurance companies, and even cell phone and other utility companies all reportedly utilize credit scores to help determine their business and credit relationships with consumers. This means that your credit is the most important component of your entire financial portfolio. Because of this, monitoring and managing your FICO score is vital, especially if you're looking to buy or refinance a home anytime in the near future.

The FICO scoring system was created in the 1960s by Fair Isaac Corporation and has been the standard for lenders since the 1980s. FICO credit scores typically range between a low score of 300 and a high score of 850. Under the FICO system, securing credit becomes less expensive for borrowers with higher scores (those who represent the least risk) and more expensive for borrowers with lower scores (those who represent the most risk). In fact, when it comes to a mortgage, a lower credit score could easily cost a consumer hundreds of thousands of dollars more in interest throughout the life of the loan, compared to the same loan with a higher score.

FICO Scores	APR	Monthly Payment
760-850	5.751%	$1,751
700-759	5.973%	$1,793
660-699	6.257%	$1,849
620-659	7.067%	$2,009
580-619	9.165%	$2,449
500-579	10.194%	$2,676

Source: Myfico.com (30 year fixed-rate mortgage on $300,000)

The above chart from MyFico.com clearly reveals the relationship between higher FICO scores and lower interest rates and monthly mortgage payments. According to Experian®, one of the three main credit bureaus in the US, FICO scores also accurately reflect "the likelihood of a borrower becoming delinquent on a loan or credit obligation in the future." In other words, the FICO scoring model looks to the past to "predict" the future risk a borrower represents to a bank or lender, and then prices the loan accordingly.

Not long ago, a FICO score of 680 was pretty good. In a tough credit market like today's, however, a 680 could be devastating to the bottom line of consumers looking to buy or refinance a home. In fact, thanks to Loan Level Price Adjustments (LLPA) from Fannie Mae and Freddie Mac, having less than a 720 in today's credit environment will cost you big: up to 2% in points or up to a 1% increase in your interest rate!

LLPAs are mandatory surcharges based strictly on credit scores. They are additional fees paid to Fannie Mae or Freddie Mac, not your mortgage professional. Analysts suggest that imposing these "penalties" is a blatant effort to recoup - and to help lessen further losses - on foreclosures. The surcharge could mean thousands of dollars for borrowers who do not monitor and maintain a good credit rating.

If you're thinking about buying, selling, or refinancing a home, you have to be credit ready. Give us a call today for a free credit consultation. We'll pull your credit and see where you stand. Remember, effective credit repair, if necessary, could take up to 3-6 months, so act now and be credit ready in no time.

Stay tuned for more great credit tips!