

# A Guide To Credit

*How credit works, and tips to improving your credit score*



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## Credit Scoring

### Credit scores and your mortgage approval

A credit score essentially is a numerical "score" based on one's ability to pay credit/debt over time. It is used by lenders to assist them in determining which loan program and interest rate can be made available to you.

The mortgage industry started utilizing "scoring models" in the early 1990's. The use of scoring models in the mortgage industry came about as the major secondary market players known as Fannie Mae and Freddie Mac developed new automated underwriting systems. Those systems compare payment histories from literally millions of similar loans coupled with the credit score of the applicant.

The early creators of the automated underwriting systems believed that, if someone could go to a Mercedes dealership at 10 am and drive off the showroom floor an hour later with a \$100,000 car (a depreciating asset), they ought to be able to obtain a home loan (an appreciating asset) the same way. The mortgage industry has been slow to adapt, but finally scoring models now figure prominently in the future of how people obtain home mortgages.

There are three major repositories of credit and background information: Equifax, Experian and TransUnion. When a consumer obtains credit, the creditor reports the payment history to these repositories. This is generally done monthly.

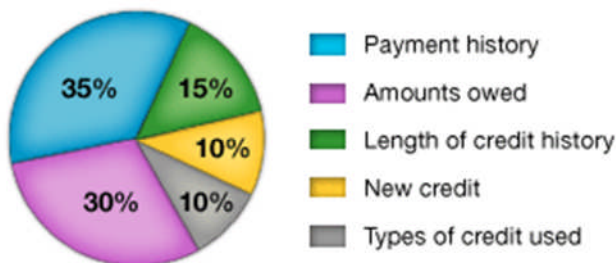
These repositories simply accept the information as it comes in electronically. This is very important to remember, they DO NOT check the accuracy of the information.

### Scoring Models

There are many different scoring models offered by the credit bureaus. Unfortunately, the models used to generate credit scores for consumers are not the same as the model used for lenders. This means that the credit scores a consumer gets when they order their credit report will differ from the scores that a lender gets. This makes the scores a consumer receives almost useless, except as a comparison to future scores the consumer orders. It is important to understand this issue and not to get upset if the scores we give you vary from what you were given. The scores we use are the same scores that all other lenders use, and are not available to consumers. We generally recommend not paying extra for these scores when ordering your own credit report.

### How credit scores are calculated

Each credit bureau uses its own proprietary scoring model to calculate your credit score, but are they very similar. Your credit score is a 3 digit number used to evaluate your overall credit risk. The higher your score, the lower risk you present to the lender. Your score is derived from 5 key factors:



### Payment History

Payment history makes up 35% of your credit score, and is the largest factor. Therefore, it is extremely important that you pay your bills on time every month. If you are late now, get yourself current, and stay current. The longer you are current, the better your credit score will be.

## Amounts Owed

This generally refers to the amount you owe on your revolving debt (credit cards, store cards, etc) as compared to the limits on those accounts. If you are near or at your limits, that will have a negative impact on your score. You want to keep your balances to no greater than 50% of your limit, and ideally below 35%. The lower they are, the better your score will be. Paying down your revolving debt (but not closing the account if paid down to zero) is one of the best ways to quickly increase your credit score.

## Length of credit history

The length of time you have maintained credit, and the average age of your active accounts, will have an impact on your credit score. Someone who only has new accounts will not be looked at as favorably as someone who has a long history of paying their bills. Therefore you only want to apply for new credit if it is needed, and you do not want to close accounts unless necessary. Closing an old account or opening a new one will reduce the average age of your accounts.

## New Credit

Applying for or opening new credit can negatively impact your score. You should only apply for credit you need. However, different inquiries are judged differently. For instance, you are not penalized for shopping for the best car loan or mortgage. All of those inquiries in a given amount of time is considered one event, and therefore only one inquiry.

## Types of credit used

It is important to try to maintain a blend of different types of accounts. Ideally you would have 2-3 revolving accounts (credit cards), 1-2 installment loans (car loan, personal loan, etc) and a mortgage. This blend, in conjunction with the items mentioned above, will yield you the best possible credit scores.

## Credit Score Guidelines

As a key component in evaluating you as a credit risk, lenders use this information to see if you have missed payments, carry high balances, or are in other ways over extending yourself financially. The following categories are a general guideline to borrower creditworthiness (these are general guidelines only - other factors may be included in your credit evaluation and the approval process):

### Excellent Credit

Credit scores of 740 and above

- 5 trade credit lines (credit cards, auto loans, mortgages) each having been open for at least 24 months
- All accounts have been paid as agreed
- No public records of bankruptcy, foreclosure, serious past due accounts, or collections within the last 10 years
- Low current credit balance relative to maximum available credit limit
- Minimum number of credit inquiries

### Very Good Credit

Credit scores between 700-739

- 5 trade credit lines (credit cards, auto loans, mortgages) have each been open for at least 24 months
- All accounts have been paid as agreed
- No public records of bankruptcy, foreclosure, serious past due accounts, or collections within the last 7 years
- Low current credit balance relative to maximum available credit limit
- Minimum number of credit inquiries

### Good Credit

Credit scores between 660-699

- 5 trade credit lines (credit cards, auto loans, mortgages) have each been open for at least 24 months
- Most accounts have been paid as agreed, with only occasional late payments
- No public records of bankruptcy, foreclosure, serious past due accounts, or collections within the last 7 years
- May have significant current credit balance relative to maximum available credit limit
- Several recent credit inquiries

### Fair Credit

Credit scores between 620-659

- 3 trade credit lines (credit cards, auto loans, mortgages) have each been open for at least 24 months
- Most accounts have been paid as agreed, with only occasional late payments
- No public record of bankruptcy, foreclosure, serious past due accounts, or collections within the last 2 years
- May have significant credit balance relative to maximum available credit limit
- Several recent credit inquiries

## **Poor Credit**

Credit scores 619 and below

- One or more accounts have not been paid as agreed
- May have had a bankruptcy, foreclosure, serious past due accounts or collections recently
- High number of recent credit inquiries
- Proportion of revolving balances to revolving credit limits is too high

## **Improving your Credit**

### **Get yourself current**

If you are currently delinquent on some or all of your accounts, bring them current and stay current. Since your payment history is the largest factor in your credit score, it is extremely important to always pay your bills on time.

### **Pay down your debt**

Paying down your revolving debt is the fastest way to have a positive impact on your credit score. Generally, you should keep your balances to no more than 50% of your limit, and ideally to less than 35%.

### **New credit**

Only apply for credit you need. Opening or applying for new credit can have an adverse effect on your credit score. Therefore, only apply for credit you need. Also, do not close old accounts unless necessary, as that will reduce the average age of your accounts.

### **Correct mistakes on your credit report**

If there are errors on your credit report, it is important to get them removed or corrected. Incorrect credit bureau data can negatively impact your credit score. You will need to first order a copy of your credit report directly from each bureau, then dispute the incorrect information directly with the bureau. The contact information for each credit bureau can be found on the last page of this document.

## **Establishing New Credit**

Having no credit can sometimes be as bad as having bad credit. It is, however, a much easier problem to solve. If you have little or no good credit, the best option is to establish new credit and maintain a positive payment history on it. Our recommendation is to start with 2-3 credit cards. You will want to use these credit cards every month, and make the payments on them every month on time. Also, remember not to max out the card, try to keep it at no more than 35% of the limit.

If you have trouble being approved for a traditional credit card, you can get secured credit cards. A secured credit card works the same way as a traditional credit card, but it is secured by a deposit that you will make with the card holder. For instance, if you make a \$500 deposit with the card holder, they will give you a credit card with a \$500 limit. You then use and pay for the card the same way you would on a traditional card. They report to all 3 credit bureaus. Depending on the card, the deposit you make may generate interest, and often the account can be switched to a traditional account after 12 months and your initial deposit is refunded.

Once you have established new credit, and have made on-time payments on those accounts for a few months, your score will begin to increase, and will continue to increase as long as those accounts are maintained in good standing.

For a list of companies that offer good credit cards to those with bad credit or no credit, see the last page of this document.

When you feel that your credit has been fully re-established, and you are ready to once again apply for a mortgage, contact one of our loan experts at (888) 894-3793. You can also apply online at <http://apply.gorhf.com>.

## Frequently Asked Questions

**Q:** Does pulling my own credit affect my score?

**A:** No. When you pull your credit, it is considered a 'soft' pull, and will not affect your score.

**Q:** I have old collection accounts, should I pay them off?

**A:** While we always recommend paying back debt that you owe, paying off an old account may actually hurt your credit score short term. The older an item is, the less it impacts your credit score. By paying off an old account, you bring that account's date of last activity to now, increasing the affect it has on your credit. Before paying off old accounts, speak with your Residential Home Funding mortgage consultant to determine if that is something that should be done prior to buying a house, or after.

**Q:** Should I close old accounts that I don't use?

**A:** No, you should not. Closing old accounts can negatively affect your score in two ways. First, it reduces the average age of your accounts, and second, it can increase the proportion of balances to limits on your revolving accounts. You should only close old accounts if you absolutely need to.

**Q:** Should I use debt settlement to help pay off my debt?

**A:** Not unless absolutely necessary. Debt settlement will negatively impact your credit and prevent you from qualifying for a mortgage for at least 2 years.

**Q:** I have a judgment on my credit. Does that need to be paid?

**A:** Any liens and judgments on your credit will need to be paid off before you will be able to close on a mortgage.

**Q:** I had a bankruptcy in the past, can I get a mortgage?

**A:** A bankruptcy will prevent you from getting a mortgage for a period of time. The amount of time you will need to wait depends on the mortgage product and the type of bankruptcy. Generally, you will need to wait at least 2 years from the time the bankruptcy was discharged for a chapter 7, and at least 1 year from filing for a chapter 13.

**Q:** I am in consumer credit counseling, can I get a mortgage?

**A:** Yes. However, at least 1 year of the payments must have been made satisfactorily and you must obtain written permission from the counseling agency to enter into a mortgage.

For any other questions, please contact one of our loan experts at (888) 894-3793. You can also visit us online at <http://www.gorhf.com>.

## Reference Information

Credit Bureaus:

### **Equifax Credit Information Services, Inc.**

(800) 685-1111

P.O. Box 740241 (Order a report)

P.O. Box 740256 (Dispute an item) Atlanta, GA 30374

### **Experian - National Consumer Assistance Center**

(888) 397-3742

701 Experian Parkway

P.O. Box 2002 Allen, TX 75013-0036

### **Transunion Consumer Solutions**

(800) 888-4213

P.O. Box 1000 (Order a report)

P.O. Box 2000 (Dispute an item) (800) 916-8800 Chester, PA 19022

## Credit Cards

### [Orchard Bank](#)

Part of HSBC, Orchard Bank offers several credit cards, both traditional and secured, for individuals needing to rebuild their credit. The unsecured cards come with annual fees between \$39 and \$59, and APRs that range from 14.9% to 19.9%. Their secured card requires a minimum deposit of \$200 and has 7.9% APR and a \$35 annual fee (waived for the first year).

### [Capital One](#)

The Capital One Secured MasterCard offers a higher limit than the initial deposit, which is unique. The APR is fairly high though, at 22.9%, so it's best not to carry a balance on this card.

### [Navy FCU](#)

If you have military ties, and can become a member, the Navy Federal Secured Card is one of the best options for people with poor credit. The card has a low 8.99% APR, no annual fee, and offers a reward system redeemable for merchandise or gift cards. After 12 months the card can be switched to an unsecured card.

### [CitiBank](#)

The Citi Secured MasterCard deposits your money into a CD, as opposed to a non-interest bearing account. This means that your initial deposit earns interest while it is being held. The card also has a fairly low \$29 annual fee. Citi will consider graduating you to an unsecured card after 18 months.

### [Public Savings](#)

The Public Savings Open Sky Secured Visa Card boasts a very low 9.75% rate, and only requires an initial deposit of \$200, for a limit of up to \$3000. Public Savings will accept anyone, without a credit check. They report to all 3 credit bureaus. The annual fee \$50.