About

How Your Credit Score is Calculated

From Janet Wickell,Your Guide to Home Buying / Selling.

Your Credit Scores Affect Your Home Buying Ability

Home buyers who are seeking a loan find out early-on that their credit scores play an important part in the home buying process and in determining the interest rate that a lender offers.

It's a good idea to learn as much as you can about your credit reports and credit scores before you apply for a loan. If your credit reports include mistakes, you'll need some time to get them corrected. Some negative information can be removed—with the help of your creditors—but that process also takes time.

What is a credit score?

A credit score is a number that lenders use to estimate risk. Experience has shown them that borrowers with higher credit scores are less likely to default on a loan.

How are credit scores calculated?

Credit scores are generated by plugging the data from your credit report into software that analyzes it and cranks out a number.

The three major credit reporting agencies don't necessarily use the same scoring software, so don't be surprised when you discover that the scores they generate for you are different.

Why credit scores sometimes called FICO scores?

The software used to calculate a vast number of reports was created by Fair Isaac Corporation (FICO).

Which parts of a credit history are most important?

The pie chart above right shows a breakdown of the *approximate* weight each aspect of your credit report brings to the credit score calculation.

> 35% - Your Payment History
> 30% - Amounts You Owe
> 15% - Length of Your Credit History
> 10% - Types of Credit Used
> 10% - New Credit

Payment History Stats:

- Number of accounts paid as agreed
- Delinquent accounts:
  1. length of past-due status
  2. total number of past due items
  3. how long it's been since you had a past due payment
- Negative public records or collections

What You Owe Weighs In:

- How much you owe on accounts and the types of accounts you carry balances on
- How much of your revolving credit lines you've used (looking for indications you are maxed-out)
- Amounts you owe on installment loan accounts vs. their original balances (are you paying them down consistently?)

- Number of zero balance accounts

Length of Credit History:

- Total length of time tracked by your credit report
- Length of time since accounts were opened
- Time that's passed since the last activity
- The longer your (good) history, the better your scores

Types of credit you use

- Total number of accounts and types of accounts (installment, revolving, mortgage, etc.)
- A mixture of account types usually generates better scores than reports with only numerous revolving accounts (credit cards)

Your New Credit:

- Number of accounts you've recently opened and the proportion of new accounts to total accounts
- Number of recent credit inquiries
- The time that's passed since recent inquiries or newly-opened accounts
- If you've re-established a positive credit history after encountering payment problems
- In general, checking to make sure you aren't out there opening up numerous new accounts

Credit scoring software *only* considers items your credit report, but lenders typically look at other factors that aren't included in the report, such as income, employment history, and the type of credit you are seeking.

What's a *Good* Credit Score?

Credit scores (usually) range from 340 to 820. The higher your score, the less risk a lender believes you will be. As your score climbs, the interest rate you are offered will probably decline.

Here's an overview of credit scores among the US population in 2003:

Up to 499: 1%
500 - 549: 5%
550 - 599: 7%
600 - 649: 11%
650 - 699: 16%
700 - 749: 20%
750 - 799: 29%
Over 800: 11%

Borrowers with a credit score over 700 are typically offered more financing options and better interest rates, but don't be discouraged, because there's a mortgage product for nearly every score.

Mortgage lenders look at more than one score...

Your bank will pull credit reports and scores from all three major credit reporting agencies: Transunion, Equifax, and Experian. They'll probably use the middle score to work your loan application. Ask your lender to explain which credit scores will be used and how they affect your loan application.

Next...

- Improving Your Credit Score