Every Buyer needs to understand their credit in home buying

Credit scores affect what interest rate a home buyer can get! . To help you better understand lenders' use of credit scoring in their underwriting decisions, NAR recently worked with Freddie Mac to produce educational materials on the topic

Credit scoring -- assigning numerical ratings to consumers on the basis of your credit history -- has been used for more than 30 years by auto lenders, credit card issuers, and other extenders of consumer credit. And, of course, it's been used to determine whether your homebuyers qualify for mortgages, as well. Some say credit scoring widens the market, helps more people get a mortgage by removing human biases from the approval process, and offers flexibility for buyers pushing the standard debt ratios but who have proved their ability to handle debt

Fannie Mae and Freddie Mac, which, in an average year, purchase about 58 percent of all residential conforming mortgages, began in mid-1995 to encourage or recommend the use of credit scores by lenders. Then both the agencies introduced automated underwriting systems for lenders that include credit scoring.

In the former years, qualifying for a mortgage was as simple as paying your bills on time for two years, not paying more than 28 percent of your monthly income for housing and no more than 36 percent for other debts "It's not that simple anymore.

Credit scoring uses reports from any of the three major credit repositories -- Equifax, Experian, and Trans Union -- to grade consumers on a 900-point scale. The scores are calculated by the credit bureaus, not by lenders. The credit score isn't a permanent part of any credit history but rather a snapshot of a mortgage applicant's credit history. Fannie Mae recommends that lenders do comprehensive reviews of borrowers with scores between 620 and 660. If the score is lower than 620, the down payment could be higher for borrowers to qualify for a conventional mortgage.

If you don't qualify you may have to turn go sub prime for a mortgage, which carry rates one-quarter to 4 percentage points higher than prime or conventional mortgages. The fees and closing costs may also be higher.

Both Freddie Mac and Fannie Mae tell lenders that loans should be neither approved nor rejected on the basis of credit scores alone, but many lenders say they fear they will have greater difficulty selling their loans to either agency if scores are much below 620.

The more than 100 variables used in credit scoring include the following:
1) Existing credit cards and other open or active accounts, their type, the length of time credit has been available, and credit levels
2) Current level of indebtedness and its relation to available credit
3) Outstanding auto loans and other loans
4) Credit performance, including the number and severity of late payments, delinquencies and collections
5) Number of inquiries or attempts to acquire additional credit, especially in recent months

The object is to establish a numerical measurement that reflects a borrower's likelihood of repaying the mortgage loan on time -- the borrower's default risk. Every scoring model uses the same data to establish a score, but the weight attached to each component of the score is different with each model.

Need more understanding? Let us put you in contact with an expert lender who can help. As you can see this is very complicated and very important.