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Directors Financial Group
Real Estate Financing

Your Credit Score

What It Means to You as a Prospective Home Buyer

Introduction

The subject of credit scoring has become an increasingly hot topic, and for good reason. For many years, the general public only associated the concept of credit scoring with the need to purchase high-ticket items such as a new car or a home. Today, credit scoring goes much further. Your credit score can affect your ability to get a good rate on commodities such as car insurance, cell phones, or even determine whether or not you get the job or promotion that you want and deserve. Indeed, the financial snapshot provided by the credit score has also become a gauge for many employers, especially those who seek to place employees in a position of management or financial responsibility.

The History of Credit Scoring

The credit score system used today has evolved since the 1950s. It was originally designed to provide lenders with financial profiles on consumers who wished to borrow money. The lenders' biggest concern was whether or not an individual had the ability to repay a loan, and establish what percentage of risk might be involved.

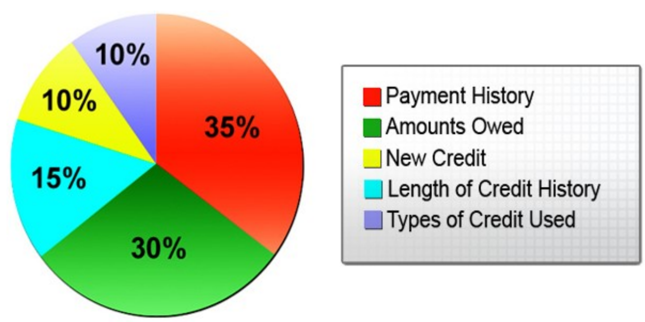
Congress passed the Fair Credit Reporting Act in 1971 to establish guidelines for fair practices in regard to the use of credit scoring. This law was designed to promote accuracy in reporting and protect the privacy of consumers. In light of the increased use of credit scoring and a growing fear of identity theft, recent legislation has been passed to further protect Americans and improve consumer awareness.

The Fair and Accurate Credit Transactions Act of 2003 (sometimes referred to as The FACT ACT or FACTA) was signed by President George W. Bush on December 4, 2003. This amended the Fair Credit Reporting Act, enabling each American to obtain one free credit report every 12 months from each of the three main credit reporting agencies (CRAs); Equifax, Experian® and TransUnion®. Those bureaus have created a central web site, www.annualcreditreport.com, to accommodate Americans who wish to obtain copies of their credit report. Note: If you decide to take advantage of this program, please keep in mind that annualcreditreport.com does not offer free credit scores with your reports. However, you can purchase your score at the same time that you order your free report for around $7.95 per bureau. To have a complete picture of where you stand with your credit, it is always recommended that you order your scores at the same time.

Why Your Credit Score is So Important

The credit scoring model seeks to quantify the likelihood of a consumer to pay off debt without being more than 90 days late at any time in the future. Credit scores have many different ranges, however, the score that is used by 90% of lenders and creditors in this country is the FICO score, and the FICO score range is 300 to 850. Credit scores can range between a low score of 300 and a high score of 850. The higher the score, the better it is for the consumer, because a high credit score translates into a low interest rate. This can save literally thousands of dollars in financing fees over the life of the loan.

Only one out of 1,300 people in the United States have a credit score above 800. These are people with a stellar credit rating that get the best interest rates. On the other hand, one out of every eight prospective home buyers is faced with the possibility that they may not qualify for the home loan they want because they have a score falling between 500 and 600.



The Five Factors of Credit Scoring

Credit scores are comprised of five factors. Points are awarded for each component, and a high score is most favorable. The factors are listed below in order of importance.

1. **PAYMENT HISTORY - 35% IMPACT**
   Paying debt on time and in full has the greatest positive impact on your credit score. Late payments, judgments and charge-offs all have a negative impact. Delinquencies that have occurred in the last two years carry more weight than older items.

2. **OUTSTANDING CREDIT CARD BALANCES - 30% IMPACT**
   This factor marks the ratio between the outstanding balance and available credit. Ideally, the consumer should make an effort to keep balances as close to zero as possible, and definitely below 30% of the available credit limit at least 2-3 months prior to trying to purchase a home.

3. **CREDIT HISTORY - 15% IMPACT**
   This portion of the credit score indicates the length of time since a particular credit line was established. A seasoned borrower will always be stronger in this area.

4. **TYPE OF CREDIT - 10% IMPACT**
   A mix of auto loans, credit cards and mortgages is more positive than a concentration of debt from credit cards only. You should always have 1-2 open major credit card accounts.

5. **INQUIRIES - 10% IMPACT**
   This percentage of the credit score quantifies the number of inquiries made on a consumer s credit within a twelve-month period. Each hard inquiry can cost from two to 25 points on a credit score, depending on the amount of points someone has left in this factor. Note that if you pull your credit report yourself, it will have no effect on your score.

Remember that the credit score is a computerized calculation. Personal factors are not taken into consideration when a credit report is generated. It is merely a snapshot of today's credit profile for any given borrower, and it can fluctuate dramatically within the course of a week.

How Does a Low Credit Score Affect My Interest Rate?

Here s a short list of how much low credit scores can cost when it comes to a mortgage*:

1. **You May Never Own A Home AT ALL, AGAIN, Or FOR YEARS**

Whether or not you ve always had poor credit, or have just suffered from the recent mortgage crisis, this is a very real possibility for individuals. If you have low scores or problematic reports, lenders will either deny you flat out or penalize you with such exorbitant rates that the outcome ranges from completely undesirable to impossible.

2. **You Will Pay Higher Interest Rates**

It just makes sense that if you have higher credit scores, you will pay a lower interest rate on your mortgage loan and will have to put less down. Fair Isaac's consumer website at http://www.myfico.com offers a mortgage payment calculator that is updated regularly to show consumers how their FICO score can affect their interest rate.

Per myfico.com, if your credit scores are under 620, consumers could pay $1420 more per month than someone with a 720 credit score for a 30-Year Fixed Rate Mortgage with a loan principal amount of $300,000. That s an additional $17,040 per year, and approximately $511,151 over the life of the loan.

Of course, interest rates are determined by many factors but the bottom line is that individuals with **low credit scores will pay nearly three times more in interest than those with strong credit scores.** 3. **Now You Will Be Subject To Loan Level Price Adjustment Fees (LLPA s) when applying for a conventional mortgage.**

Consumers with a middle score of less than 719 will now be charged an LLPA fee which was implemented by Fannie Mae and Freddie Mac in March of 2008. See the following chart to see where your scores fall:

FICO Score	LLPA You Will Pay
Below 620	2.750%
620-639	2.250%
640-659	1.500%
660-679	1.000%
680-719	0.250%

For people experiencing the worst-case scenario, carrying a middle credit score of less than 620 could cost you an extra $8,250 upfront on a $300,000 loan amount.

4. **You Will Pay More For Private Mortgage Insurance (PMI)**

PMI is insurance that mortgage lenders require from most homebuyers who have less than a 20% down payment on their property. If your credit scores are marginal, your private mortgage insurance rate might be hundreds of dollars higher per month than you expect, and you usually don t find this out until closing.

5. **5. You Will Compromise Your Ability To Refinance For Cash Out**

As you build equity in the ownership of your home, you may decide to borrow against that equity for the purpose of home improvement, debt consolidation, or even to pay college tuition for your children. Lower credit scores will not only affect your ability to take out a home equity line of credit (HELOC), but you will also have to pay higher interest rates and other upfront costs if you are approved.

*SOURCE: Linda Ferrari s Book, The Big Score The Cost of NOT Paying Attention, www.lindaferrari.com

How Does the Underwriter View My Score?

If you are considering a home purchase, it is in your best interest to make every effort to increase your credit scores as early in the process as you can, especially if you know you have issues you should be dealing with. It is often the case that people are not aware of bad marks on their credit record until they apply for financing for a major purchase, such as a home.

Today, you have access to your credit information all day and every day. This is wonderful news. Consumers now have the opportunity to quickly correct and maintain credit reports. It is mission critical for consumers to seize that advantage by assuming responsibility. Lenders, employers, and vendors judge us based on our credit reports, and they know that we are capable of doing so. The days of excuses are in the rearview mirror.

Reports from the credit bureaus*. You can get started by acquiring a copy of your credit reports from each of the three major CRAs. It s important to get reports from each of the three not just one. The CRAs do not share data, so you need to get a full accounting of everything that is being reported.

The reports that you receive directly from the three credit bureaus are easy to read. More importantly, going straight to the source of the data will ensure that your action plan begins with the most complete information being reported about you. This includes your credit accounts, your credit history, and your personal and demographic information.

You can order your credit report and score from each credit bureau online, through the mail, or via telephone. Here is the information you need:

- Equifax: (800) 685-1111 - http://www.equifax.com Cost: $15.95
- Experian: (888) 397-3742 - http://www.experian.com Cost: $15.00
- TransUnion: (800) 916-8800 - http://www.transunion.com Cost: $14.95

Be sure to call for the most recent mailing information when you are ready to contact the bureaus by mail. You can also use these numbers to order your reports by phone.

Free credit reports*. By law, each of the CRAs must provide a free copy of your credit report, at your request, once every 12 months. To read more about this, a good source is the Federal Trade Commission s Consumer Alert that you can download here

You can access this program in one of three ways:

a) Go to http://www.annualcreditreport.com; or

b) Call 1-877-322-8228; or

c) Complete the Annual Credit Report Request Form and mail it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. You can download the form with instructions at here.

Remember, annualcreditreport.com does not offer free credit scores with your reports. However, you can purchase your score at the same time that you order your free report for around $7.95 per bureau. To have a complete picture of where you stand with your credit, it is always recommended that you order your scores at the same time.

The underwriter who is making the decision as to whether or not you should get the loan you are asking for will generally look at the scores generated from all three CRAs. Typically, the score will not be the same from all three reports, and the underwriter will consider the middle score as a barometer.

*SOURCE: Linda Ferrari s Book, The Big Score Getting Your Reports, www.lindaferrari.com

Disputing Errors On the Credit Report

The U.S. Public Interest Research Groups (USPIRGs), conducted a 30-state study on the subject of credit scoring, and published their own report: Mistakes Do Happen: A Look at Errors in Consumer Credit Reports. The study revealed that 79% of consumer credit reports contain errors. What's more, there's a one-in-four chance your credit report contains an error serious enough to cause you to be denied credit.

Here s a breakdown of their findings:

- Twenty-five percent (25%) of the credit reports contained errors serious enough to result in the denial of credit;
- Seventy-nine percent (79%) of the credit reports contained mistakes of some kind;
- Fifty-four percent (54%) of the credit reports contained personal demographic information that was misspelled, long-outdated, belonged to a stranger, or was otherwise incorrect;
- Thirty percent (30%) of the credit reports contained credit accounts that had been closed by the consumer but incorrectly remained listed as open.

SOURCE: U.S. Public Interest Group Research; *One In Four Credit Reports Contains Errors Serious Enough To Wreak Havoc For Consumers*, US PIRG Press release, 06/17/04 http://uspirg.org/uspirgnewsroom.asp?id2=13650&id3=USPIRGnewsroom

If you find that you have errors on your credit report, follow this procedure to correct those errors.

1. Make a copy of the report and circle the item(s) you are questioning. Keep your original copy for your own records.
2. Prepare a letter to the CRA that provided you with the report in question, and request to have the erroneous item(s) removed or corrected. If you have proof of payment for an item in question, include a copy of that documentation.

3. Prepare a letter to the creditor reporting the problem, especially if you feel you are a victim of fraud or identity theft. Inform the creditor that you are disputing an error reported to the CRA, state why the claim is inaccurate, and include any relevant documentation to prove your point.

4. Send your correspondence via certified mail and, to avoid delay in their replies, always attach proof of social security and proof of address right from the beginning.

You should receive a response from the CRA within 30 to 45 days. If the error has been corrected, they will send you a fresh copy of your credit report at no charge to show you that the item has been removed or corrected.

If you cannot have a disputed item removed, you have the right to include your side of the story on the credit report. Your statement should be a concise explanation (100 words or less) as to why you are challenging the item in question. From that point on, this notation will be included in your credit report as long as the item in question remains on your report.

If the bureaus do not respond within 35 days, send a formal complaint letter reminding them that per Section 611 of the Fair Credit Reporting Act they are required to respond within 30 days from the date they received your initial dispute. Also remind them that per Section 616 & 617 of the same Act they are liable for damages, including punitive, and that if necessary you will seek legal representation. Attach your original dispute letter and proof of delivery to the complaint. In addition, just because the credit bureau has determined an item investigated does not mean the results are accurate. If you are 100% sure that your claim is true and accurate, and the bureau responds stating that the creditor has verified the information and the item will not be removed or updated, you must request a reinvestigation under Section 611 of the Fair Credit Reporting Act. It s best to do so within 5 days of receiving the results of their investigation.

You can repeat this process as many times as you want; however, after three to four attempts, you may consider filing a complaint with the Federal Trade Commission Consumer Response Center. You may be able to have your case added to a class action lawsuit against the bureau that is reporting the inaccurate information. You can access the FTC Complaint Wizard at http://www.ftc.gov/bcp/index.shtml, or you can mail a complaint letter to the following address:

Federal Trade Commission
Consumer Response Center
600 Pennsylvania Avenue, NW
Washington, DC 20580

If you do not have proof in support of your claim and the CRAs refuse to remove the disputed item, you also have the right to include your side of the story on the credit report. Your statement should be a concise explanation (100 words or less) as to why you are challenging the item in question. From that point on, this notation will be included in your credit report as long as the item in question remains on your report.

What If I Have No Credit?

On occasion, borrowers will not have enough credit references to obtain the loan they wish to secure. If this is the case for you, start by opening small lines of credit that report to all three major CRAs, and make purchases that can be paid off easily. If you do not already have a checking or savings account, open one. Your bank or credit union may be able to provide you with a credit card account once you have established a history with them as a customer.

If you do not have established credit, you are not completely out of luck. Some lenders will pull a report that will show them whether or not consumers pay their rent and utility bills on time. If they like what they see, they may approve you for credit. That is why it is extremely important to pay these day-to-day living expenses on time. In addition, your ability to hold a steady job will improve the likelihood of being approved for credit.

It is also wise to start saving money for the down payment on your home. The lender will look at your application more favorably when you are able to come to the table with a 20% down payment. Bear in mind, there are certain loan programs available that permit a percentage of gift money for down payment, which can come from a relative, or even the person selling the home.

Dealing with Credit Challenges

Unfortunately, a person with a bad credit score is often in this position because he or she lacks the discipline to pay bills on time.

Of course, there are exceptions where unforeseen circumstances come into play, such as health complications, or loss of employment.

There are a few things that may be able to bring your score up so that you can secure a better interest rate on your mortgage loan.

Example 1: Distribute debt from revolving credit.
Our borrower, Mr. Jones, has a credit score of 664. He has five credit cards, but his Visa account is almost maxed out. His other four credit cards have relatively low balances. Mr. Jones moves part of the debt from the Visa account to the other major credit card accounts, thus distributing the debt more evenly over the five cards. This changes the ratio of debt to available credit (which has a 30% impact on the overall credit score), and Mr. Jones successfully raises his credit score by 20 points with very little effort. **Example 2: Transfer outstanding balances to new accounts.** Our borrower, Mr. Smith, has only two credit cards, but both are pushing the limit of available credit. Mr. Smith opens two new credit card accounts, each with a credit limit of $5,000. He transfers part of his existing balances to the new accounts. While he has acquired two new cards that have no established history, the greater impact is the change in the ratio of debt to available credit.

Ultimately, experts say that it is best to have one to three major credit cards, and no more than that. You should keep your balances as low as possible. If you have a credit account with a zero balance, do not close the account.

Instead, make a small purchase so the card shows up as an active account on your credit report, and you will be awarded points for your long-term credit history.

These are just a few tips to consider as you seek to obtain mortgage financing. But you should always know that as your loan originator, my job is just beginning when you close your loan with me.

As soon as you begin to make mortgage payments on time and in full, your credit standing will begin to improve. My team and I will continue to monitor rates on your behalf and alert you to the opportunity to refinance into a loan program with a lower interest rate as soon as possible. Our long-term goal is to help you build a strong financial future.

Dos and Don'ts During the Loan Process

When you fill out a credit appli- cation, we run a credit report for the underwriter. Each lender and each loan program has different guidelines they must follow. You should not do anything that will have an adverse effect on your credit score while your loan is in process. We know it's tempting...If you're moving into a new home, you might be thinking about purchasing new appliances or furniture, but this is really not the right time to go shopping with your credit cards. You'll want to remain in a stable position until the loan closes and give us the opportunity to help you lock in the best interest rate we can possibly get for you.

Here is a handy list of dos and don'ts that you should adhere to after your loan application has been submitted to the lender.*

DON'T APPLY FOR NEW CREDIT OF ANY KIND - If you receive invitations to apply for new lines of credit, don't respond. If you do, that company will pull your credit report and this will have an adverse effect on your credit score. Likewise, don't establish new lines of credit for furniture, appliances, computers, etc.

DON'T PAY OFF COLLECTIONS OR CHARGE-OFFS - Once your loan application has been submitted, don't pay off collections unless the lender specifically asks you to in order to secure the loan and we recommend that you do everything possible to negotiate deletion in exchange for payment. Generally, paying off old collections causes a drop in the credit score. The lender is only looking at the last two years of activity.

DON'T CLOSE CREDIT CARD ACCOUNTS - If you close a credit card account, it can affect your ratio of debt to available credit which has a 30% impact on your credit score, and also your length of credit history which has a 15% impact on your credit score. If you really want to close an account, do it after you close your mortgage loan.

DON'T MAX OUT OR OVER CHARGE EXISTING CREDIT CARDS - Running up your credit cards is the fastest way to bring your score down, and it could drop up to 100 points overnight. Once you are engaged in the loan process, try to keep your credit card balances below 30% of the available credit limit.

DON'T CONSOLIDATE DEBT TO ONE OR TWO CARDS - Once again, we don't want you to change your ratio of debt to available credit. Likewise, you want to keep beneficial credit history on the books.

DON'T RAISE RED FLAGS TO THE UNDERWRITER - Don't co-sign on another person's loan, or change your name and address. The less activity that occurs while your loan is in process, the better it is for you.

DO JOIN A CREDIT WATCH PROGRAM - Your bank, credit union or credit card company may be able to provide you with a free credit watch program that can alert you to any changes in your credit report. This can be a safeguard to help you intervene before the underwriter sees a problem.

DO STAY CURRENT ON EXISTING ACCOUNTS - Late payments on your existing mortgage, car payment, or anything else that can be reported to a CRA can cost you dearly. One 30-day late payment can cost anywhere from 50 to 100+ points on your credit score. .

DO CONTINUE TO USE YOUR CREDIT AS YOU NORMALLY WOULD - Red flags are easily raised within the scoring system. If it appears you are diverting from your normal spending patterns, it could cause your score to go down. For example, if you've had a monthly service for Internet access billed to the same credit card for the past three years, there's really no reason to drop it now. Again, make your changes after the loan funds.

*SOURCE: Linda Ferrari s Book, The Big Score Getting It & Keeping It www.lindaferrari.com

DO CALL YOUR LOAN CONSULTANT - If you receive notification from a collection agency or creditor that could potentially have an adverse effect on your credit score, call us so we can try to direct you to the right resources and prevent any derogatory reporting to credit bureaus.

* SOURCE: Based on The Top 10 Credit Do's and Don'ts During the Loan Process, provided by Credit Resource Corp. http://www.creditresourcecorp.com

Credit Remediation

If you feel you would prefer to work with a credit improvement firm rather than try to tackle your credit challenges on your own, please give us a call so we can help you sort through your options. We will do our best to refer you to a reputable credit improvement firm and guide you in the right direction once we have the opportunity to review your credit report with you.

The Federal Trade Commission (FTC) regulates credit repair services and provides free information to help consumers spot, stop and avoid doing business with credit repair companies that are not reputable. Their web site is located at http://www.ftc.gov.

You can also write to the FTC to request a copy of their free brochure titled Credit Repair: Self Help May Be Best, which includes information about credit clinics. The address to write to is:

Federal Trade Commission
Sixth and Pennsylvania Avenues, NW
Washington, DC 20004

If you have any complaints regarding your credit report or credit remediation services that you wish to report to the FTC, contact them at:

Federal Trade Commission
Consumer Response Center, Room 130
600 Pennsylvania Avenue, NW
Washington, DC 20580