10/04/2007

What is the Difference Between 'A' and 'B' Credit?

If you have recently applied for a home loan or refinance mortgage or even a car loan, the lender may have told you that you have ‘A+’ credit, or maybe he told you had ‘B’ credit or even ‘C’ credit. What do these various letters mean, and how do they affect your funding for loans?

These letters are credit ‘grades’ just like grades on tests in school. There doesn’t seem to be a uniform system among lenders in terms of what equates to an ‘A’ and what equates to an ‘F.’ The grades are based on Fair Isaac and Co. or FICO credit scores. This is a system of credit scoring that assigns individuals a three-digit score between 300 and 850 based on a number of financial factors. But while one lender might call a credit score of 700 ‘A’ credit, another lender may give it another grade. Basically, the higher your grade is from any lender, the better your chances are of getting funding and for getting good loan terms.

Because the letter grading system may be a bit ambiguous, you may find it much more useful to simply think of your score in terms of the FICO designation. Mortgage lenders especially rely on these scores to tell them whether or not to lend money to you. Prime lenders will generally not accept a credit score of 620 or less. This score means you have made some sizeable credit mistakes in the past, making you a riskier candidate for funding. If you credit is lower than 620, prime lenders will refer you to subprime, or poor credit lenders who specialize in finding loans for those with less than perfect credit.

So if mortgage funding is available for all types of credit scores, why is it better to have ‘A’ credit rather than a lower grade? It makes a difference when it comes to the interest rate you will receive on a mortgage loan. Prime loans have interest rates that usually range a point or two lower than those offered on subprime loans. In general, it seems that there is much distinction between a good score and a great score in terms of interest rates, although in today’s market some lenders have restricted their loans to only those with excellent credit.

This difference of interest rates offered to those with good scores and those with poor scores takes into account the assumption that your credit score reflects your history of dealing with credit and therefore reflects your future behavior. The FICO score measures five aspects of your credit history. The first and most important factor is your history of on-time payments on all of your credit accounts. This makes up 35 percent of your score. The next weightiest category (30 percent) is your debt-to-available credit ratio. The smaller your ratio, the better off you are. FICO also factors in the length of your credit history which accounts for 15 percent of your score, while 10 percent of your score is made up of inquiries by outside companies on your report. The final 10 percent comes from the types of credit you use, like installment loans, credit cards, leases, etc.

So while there may not be a clear-cut difference between ‘A’ credit and ‘B’ credit, there is certainly a difference between prime and subprime credit. So it’s time to study hard and improve your credit score to get the best rates and terms available!