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Understanding Your Credit to Get the Best Home Loan

These days so much of business dealings are based on your credit score. This is especially true when you are applying for a home mortgage loan. Lenders want reassurance that you will be a safe risk, that you will be responsible about repaying the loan. The current system of credit scoring gives lenders a measurement guide of your risk factor as a borrower. Before you apply, it will be very helpful for you to know what goes into your credit score and what the numbers mean.

The most common type of credit score is the FICO score, based on a system by Fair Isaac and Company. This company worked with the three major credit reporting bureaus, Equifax, TransUnion, and Experian, to create today’s popular method of scoring consumers’ credit.

Here is how it works: Your past and present relationship with credit is weighed together and given a score between 300 and 900. Any score below 620 may warrant a visit to a sub-prime (bad credit) lender. Scores above 700 are considered excellent.

Your score is calculated based on five factors. The first is your payment history. This is also the most important factor. It makes up 35% of your score. Within this segment of your score will be reflected any late bill payments, any bills that were sent to collections agencies, and more serious credit issues like bankruptcy and foreclosure. Fortunately, if you had trouble with credit several years ago, but have since worked hard to improve your habits, the recent behavior will count more in your score.

Second, 30% of your credit score is based on your current level of debt. This could include any car or home mortgage payments as well as the balances on your credit cards or remaining student loan totals. Generally, more debt equals a lower credit score. Do your best to keep your credit card balances down to about 25% or less of the spending limits.

The next factor is the amount of time you have been an active credit user. This will make up about 15% of your score. This is important to lenders because they want to see that you have a long history of making payments on time and dealing responsibly with debt. Unfortunately this is not a segment of your score that you have very much control over.

Another 10% of your credit score is based on how many inquiries have been made into your score. Inquiries take place anytime you apply for a substantial amount of credit, including credit card applications, home loans, car loans, etc. The more you have, the more it looks like you need lots of credit to cover lots of debt. Mortgage lenders try to steer clear of these types of problems.

The last 10% of your FICO score comes from the types of credit you have at your fingertips presently. This includes basically all the same types of loans and credit from the previous category. This information is most important in the scores of those who do not have long credit histories.

Now that you know how a credit score works, you will be better prepared to take the appropriate steps to improve or safeguard your score. This will help you to secure the best rate and terms on your next home mortgage loan.