Credit Scoring - How It Works

Credit scoring is a statistical method that lenders use to quickly and objectively assess the credit risk of a loan applicant. The score is a number that rates the likelihood you will pay back a loan. Scores range from 350 (high risk) to 950 (low risk). There are a few types of credit scores; the most widely used are FICO scores, which were developed by Fair Isaac & Company, Inc. for each of the credit reporting agencies.

Credit scores only consider the information contained in your credit profile. They do not consider your income, savings, down payment amount or demographic factors like gender, race, nationality or marital status. Past delinquencies, derogatory payment behavior, current debt level, length of credit history, types of credit and number of inquiries are all considered in credit scores. Your score considers both positive and negative information in your credit report. Late payments will lower your score, but establishing or reestablishing a good track record of making payments on time will raise your score. Different portions of your credit file are given different weights. They are:

- 35% - Previous credit performance (specific to your payment history)
- 30% - Current level of indebtedness (current balance compared to high credit)
- 15% - Time credit has been in use (opening date)
- 15% - Types of credit available (installment loans, revolving and debit accounts)
- 5% - Pursuit of new credit (number of inquiries)

The most important factor for a good credit score is paying your bills on time. Even if the debt you owe is a small amount, it is crucial that you make payments on time. In addition, you may want to keep balances low on credit cards and other "revolving credit;" apply for and open new credit accounts only as needed; and pay off debt rather than moving it around. Also don't close unused cards as a short-term strategy to raise your score. Owing the same amount but having fewer open accounts may lower your score.

Recent changes minimize the negative effects that rate shopping can have on a mortgage applicant. If there is a consumer originated inquiry within the past 365 days from mortgage or auto related industries, these inquiries are ignored for scoring purposes for the first 30 calendar days; then, multiple inquiries within the next 14 days are counted as one. Each inquiry will still appear on the credit report.

Every score is accompanied by a maximum of four reason codes. Reason codes identify the most significant reason that you did not score higher. The reason codes can help a lender describe the reasons for higher than expected rates or loan denial. Scores are not part of the credit profile and are not covered by the Fair Credit Reporting Act.

Your credit report must contain at least one account that has been open for six months or greater, and at least one account that has been updated in the past six months for you to get a credit score. This ensures that there is enough information in your report to generate an accurate score. If you do not meet the minimum criteria for getting a score, you may need to establish a credit history prior to applying for a mortgage.