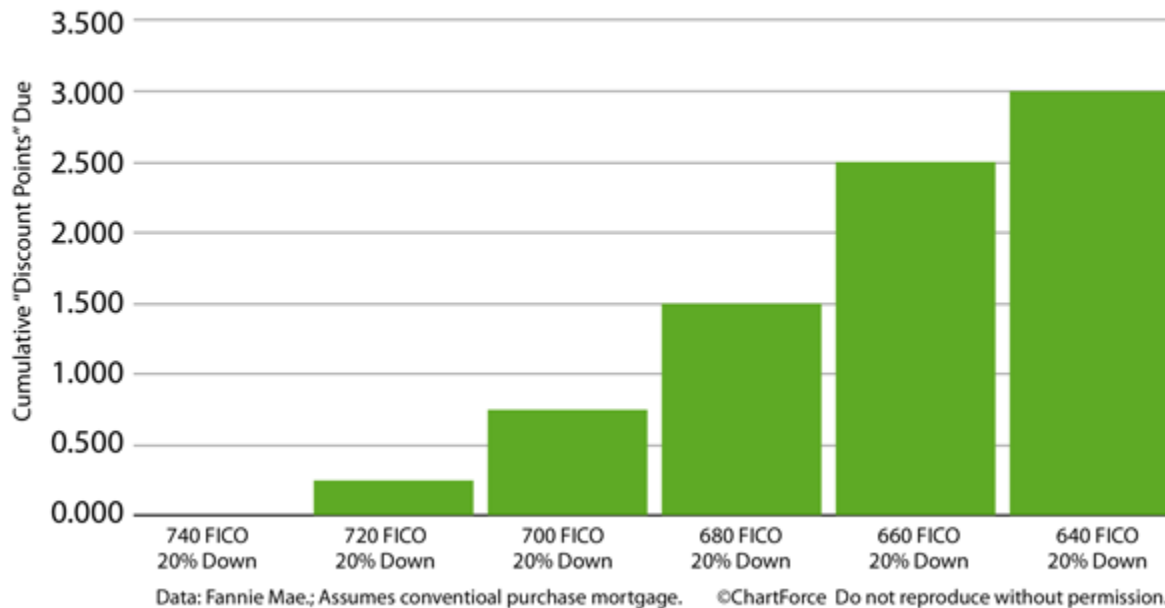


# Better Mortgage Rates Start With Better FICO Scores

## Low Credit Scores Add To Mortgage Costs



If you plan to use a mortgage for your next home purchase, you'll want to keep your credit scores as high as possible. Credit scores play an out-sized role in determining for which mortgage product you'll qualify, and to which rate you'll be assigned by your lender.

The higher your credit score, the lower your mortgage rate will be.

## What Is A Credit Score?

History has shown that the best way to predict a person's behavior over the near-term future is to look at that person's behavior in the recent past. It's a concept similar to the First Rule of Physics — an object in motion tends to stay in motion.

We can apply this theory to consumer credit, too. A person who has recently paid his bills on-time should continue to pay his bills on-time in the near-future.

This is the basis of credit scoring; using your past to predict your future.

To mortgage lenders, your credit score represents your likelihood of making on-time mortgage payments for the next 90 days. "90 days" matters because, after 90 days without payments, a homeowner falls into default.

Higher credit scores correlate with lower default risk which explains why people with high credit scores tend to receive lower mortgage rates than people with low credit scores. This is true across all loan types, including conventional, jumbo, [and FHA mortgages](#).

Like most else in finance, those with the lowest risks get to pay the lowest rates.

## Lenders Use The FICO Scoring Model, Exclusively

There are three main credit bureaus in the United States. They are Equifax, Experian and TransUnion. Each offers a bevy of credit-scoring products, available for purchase on their respective websites. Prices range from “free” to several hundred dollars.

None, however, are particularly relevant in the home-buying process. This is because the nation’s mortgage lenders rely on a different credit model — the FICO model.

FICO is named for the Fair Isaac Corporation. It was “invented” in the 1950s and has become the mortgage industry standard for credit ratings. Today, FICO scores are omnipresent to the point that people generically refer to *all* credit scores as “FICO scores”.

This is akin to calling all adhesive bandages “Band-Aids”. FICO is the brand name — not the product.

FICO scores range from 300-850.

## Credit Scores Change Mortgage Rates

Your FICO score has always influenced the mortgage rate for which you’re eligible. In 2008, though, it began to change your loan fees.

In response to major mortgage market losses, in April 2008, both Fannie Mae and Freddie Mac introduced something called Loan-Level Pricing Adjustments (LLPA). Loan-level pricing adjustments are “discount points” added to a mortgage rate, based on a specific borrower’s risk to the lender.

A discount point is a loan fee, paid at the time of closing. 1 discount point is equal to 1 percent of your loan size.

**Example : A \$300,000 mortgage that’s assessed 1 discount point will have \$3,000 in extra fees due at closing.**

Fannie Mae and Freddie Mac know that low credit scores correlate to high default rates so, like an insurance policy, they assigned the highest costs to the highest-risk borrowers.

Assuming a 20% downpayment, look at how discount points change based on credit score. Fees get massive for FICOs under 700.

- 740+ FICO : There are no discount points required. This loan is “low risk”.
- 720-739 FICO : 0.250 discount points are charged to the borrower, or \$250 per \$100,000 borrowed
- 700-719 FICO : 0.750 discount points are charged to the borrower, or \$750 per \$100,000 borrowed
- 680-699 FICO : 1.500 discount points are charged to the borrower, or \$1,500 per \$100,000 borrowed
- 660-679 FICO : 2.500 discount points are charged to the borrower, or \$2,500 per \$100,000 borrowed

Now, not many new home buyers just have that kind of extra cash just laying around. Therefore, as an alternative to paying discount points with cash, many choose to “roll up” the fees into their respective mortgage rates. In general, 1.000 discount point can be “traded in” for a 0.250 increase to your mortgage rate.

**Example : A consumer with a 680 FICO score is required to pay 1.500 discount points at closing, or can alternatively accept a mortgage rate increase of 0.375%.**

This is why it’s important to keep your credit score high. There are real dollar costs for having scores under 740.

## **Improving On Your Credit Score**

If your credit score is not as high as you’d like, the good news is that you can take steps to raise it — sometimes without even changing your spending habits.