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Greetings,

This week saw important developments on the credit rating front, which affect everyone - especially if you are contemplating a real estate transaction.

This occasional newsletter is sent to my clients and friends. You are receiving it because you signed up on my PropertyMinder web site. I appreciate your feedback and hope you find the information valuable. Of course, if you would rather not receive them, I will be happy to remove you from the list.

Equifax, Trans Union, and Experian wish to "simplify" your credit grade - and what it means to you

Earlier this month, the three major credit bureaus - Equifax, Trans Union, and Experian - announced that they have created a new scoring model called "VantageScore", based on an academic grade system of A through F. The model was created to help provide a consistent credit score between all three bureaus, since under the present system, scores can vary widely between the three. And the credit bureaus also hope that this new model will result in a more simplified loan process for both consumers and lenders.

Presently, all consumers are given a credit score, a three digit number that lenders use to evaluate the credit worthiness of borrowers. The scores are made up of many factors, including how much debt is being carried, how timely payments and overall length of credit history. **In general, the higher the score, the better the credit terms that will be offered to the borrower.**

But one problem...each credit bureau has a slightly different formula and information gathering system, so **the scores are often not consistent between the three bureaus.**

This can sometimes cause problems for lenders when working with consumers who have a large variance in scores - which causes problems for the consumer when seeking credit. The credit bureaus researched 15 million anonymous consumer credit profiles, and found that the new scoring model is likely to reduce the variance between credit scores by as much as 30%. With the new model, the factors used to create a credit score will remain the same, but the overall model will look a bit different from what has been seen in the past.

Currently the range for a credit score is 300 - 850, with 300 being the very worst possible and 850 being the very best possible. A credit score over 700 is considered excellent, 660 to 700 is average, and below 660 usually means some work needs to be done. The new model for the credit bureaus will be 501-990.

Additionally, **the new score model will be grouped and rated like the old familiar academic grades.** Scores will be grouped together and then rated from A through F, A being the highest level and F being the lowest level.

- A - 901-990
- B - 801-900
- C - 701-800
- D - 601-700
- F - 501-600

Although the new VantageScore is being introduced to banks, mortgage lenders, and credit card companies, it is not yet replacing the current model being used. VantageScore is being offered as an alternative method of determining creditworthiness, but it is a bit premature to determine whether or not the lending institutions FreddieMac and FannyMae will

actually adopt this new model as a standard. Why? "If it ain't broke...don't fix it." Although there can be some variance between the three bureaus, the current model has been working well historically. Additionally, many lenders have created extensive lending guidelines around the present scoring system, so it may not be cost effective to change the scoring model any time in the near future.

The nation's big credit reporting agencies announced on March 14 that they are launching a standardized credit score -- with grades from A to F -- to make it easier for both lenders and consumers to understand the often misunderstood ratings.

The new VantageScore from Equifax, Experian and TransUnion is intended as an alternative -- and competitor -- to the three-digit FICO score calculated by Fair Isaac.

But whether your credit score is expressed as a number or a letter, the most important thing is knowing how to establish a high rating and keep it high.

Excerpted from an article in the Mercury News this Sunday by Kathy Kristoph:

The importance of your score

A good credit score makes it easier to get a loan and can allow you to get credit at a lower cost. A top rating gives individuals access to the lowest-rate loans and the lowest fees, which can save thousands of dollars over time.

Fair Isaac, the nation's leader in credit scoring, estimates that there's more than a 1.5 percent difference in mortgage rates for those at the top of the credit scale vs. those near the middle. On a \$200,000 mortgage, that difference costs a person with the lower score almost \$200 a month -- more than \$71,000 over the life of a 30-year loan.

How are credit scores calculated and what determines your score? Equifax, Experian and TransUnion declined to detail the alchemy that goes into VantageScore. It's likely, however, to be similar to what goes into the FICO scores, which range from 350 to 850.

The formula for creating those scores works like this:

FICO first sorts each person into one of 10 credit categories so that, for instance, people with "thin files" -- not a lot of credit history -- are compared only against other people with thin files.

The formula then starts with a neutral score -- about 600 points -- and begins adding and subtracting points based on the activity shown in the file, said Craig Watts, a Fair Isaac spokesman.

Scores are based only on what is in the consumer's credit file, and that file can be different from one credit bureau to the next. So it's not uncommon for the same person to find that his or her FICO score at TransUnion is different from that at Experian or Equifax. There are also some variations in the formula, based on which of the 10 categories a person falls into and which bureau is providing the report.

Five key factors

Nonetheless, five factors account for the vast majority of any FICO credit score.

- Thirty-five percent of your credit score is based on how you have repaid your credit obligations. Points are added for people who always pay their bills on time; points are subtracted for those with some late payments, non-payments, "restructured" payments -- when the creditor agrees to take less than what's owed -- and bankruptcies. The more credit that you have used, and paid consistently, the better your score. The most serious credit mistakes take away the most points -- a bankruptcy is going to harm your score much more than a few 30-day late payments.
- Thirty percent of a score is based on your debt-to-available-credit ratio. The lower that ratio, the higher your score.

For instance, if you have a \$100,000 home equity line and four credit cards, each with \$5,000 limits, your total available credit is \$120,000. If you've borrowed a total of \$5,000 on the credit cards and \$10,000 on the home equity line, your debt amounts to \$15,000, or 13 percent of your available credit.

If, however, you have just \$20,000 in available credit and have borrowed \$15,000, you have a 75 percent debt-to-available-

credit ratio. That makes you look overextended and will result in a much lower credit score.

Moral of this story: Consolidating your debt onto one or two cards and canceling the unused cards could hurt your score by reducing the amount of credit you have available and, thus, boosting your ratio. Unless there's a compelling reason to cancel -- such as having to pay annual fees to hold those unused cards -- don't.

- Fifteen percent of your score is based on the amount of time you've managed credit. If your credit file lists experiences, from student loans to credit cards, that go back decades, you'll score better than somebody whose oldest credit experience was what was reported last month.
- Ten percent of your score is based on how many different types of credit you have handled in the past. Someone who successfully paid a mortgage, a home equity loan, a car loan and credit cards will score higher than someone who has one type of loan.

The good news: Repaid debts usually remain on your file for many years, Watts said. So you don't get penalized for responsible behavior such as paying off your car loan.

• The final 10 percent of your score is based on new credit applications and consumer-initiated credit "queries." Each time you apply for credit, a credit query hits your file. If you have a lot of those inquiries in a short period of time, this portion of your score suffers, Watts said. That's because people who apply for vast amounts of credit in a short stretch are eight times as likely to file for bankruptcy, he said.

Kathy Kristof writes this column for the Los Angeles Times. Send e-mail to kathy.kristof@latimes.com.

Read the complete article here: <http://www.mercurynews.com/mld/mercurynews/business/14191456.htm>

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