

How to Salvage an Ailing Credit Score

TODAY'S MORTGAGE COSTS ARE DIRT CHEAP—IF YOU'VE GOT THE RIGHT FICO RATING

By Luke Mullins

Without even contacting a credit bureau, Jeana Reed has a pretty good sense of what her credit score is. "It's probably the worst they've ever seen," says Reed, a 51-year-old Texan. Like many Americans, Reed's current credit headaches can be traced to a hospital stay. After her husband blew out his knee playing softball, complications from the injury kept him out of work longer than expected, which forced the couple to use credit cards to pay off medical bills. A job loss and a subprime mortgage refinancing later, the Reeds find themselves among the scores of Americans struggling to rebuild a soiled credit history. "I just want to get back on track," Reed says. "I'm not a deadbeat person."

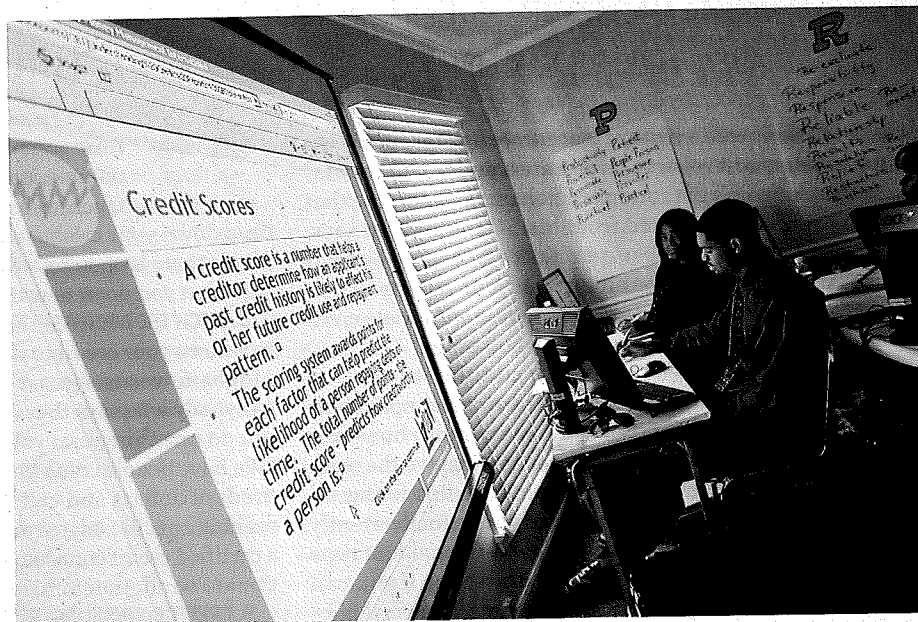
Poor credit has always been a drag on household finances, as unpaid bills and late payments can lower a consumer's FICO score—the 300-to-850-point gauge lenders use to evaluate the risk that a borrower will default. Lower FICO scores can trigger higher interest rates on everything from credit cards to car loans. But recently, they've become more important to the real estate market. Just a few years ago, Fannie Mae and Freddie Mac used FICO scores primarily in deciding whether to approve a loan application.

"That all changed as the market started to deteriorate and [Fannie and Freddie] were looking to fine-tune their mortgage pricing from a risk-based perspective," says Rick Allen, director of strategic initiatives for Mortgage Marvel, an online mortgage shopping website. Today, the mortgage finance giants use credit scores to determine mortgage costs too, jacking up fees on consumers with lower credit scores to compensate for their higher risk of default.

For would-be home buyers, this change has had powerful ramifications. With home prices declining and 30-year, fixed mortgage rates hitting near-record lows of less than 5 percent, the real estate market is offering plenty of incentives to jump in. But only borrowers who meet today's tighter credit standards—which include a FICO score of around 720, a down payment of at least 3.5 percent, and documented income verification—can get the lowest cost of financing. For example, a lender operating under Fan-

nie Mae's pricing structure would charge a borrower who has a FICO score of 695 and a 15 percent down payment \$3,000 in extra fees on a \$300,000 mortgage. A borrower with a 720 FICO score, meanwhile, wouldn't pay any of those fees on the same loan. "FICOs are everything," says Chris Freemott, president of mortgage lender All American Mortgage in Naperville, Ill.

But whether you are deep in the weeds or just looking to get the best deal on a home loan, it's never too late to improve your credit. To help consumers reduce their mortgage financing costs, *U.S. News* gleaned tips from a handful of experts on boosting your credit score.



Prospective credit counselors receive training at Money Management International in Rockville, Md.

1. GET YOUR CREDIT REPORT: The first step for improving your credit profile is to find out where your credit currently stands. Three main credit reporting bureaus—TransUnion, Equifax, and Experian—collect and compile payment information on individuals from tens of thousands of credit grantors, such as banks, credit card issuers, and retailers. "If you are about to buy a house . . . then I want you to get all three credit reports," says Gail Cunningham of the National Foundation for Credit Counseling. "I never want to end up sitting across the desk from someone who knows more about me than I do." By law, consumers are entitled to one free credit report from each of these bureaus during any 12-month period. The free reports are available at AnnualCreditReport.com.

2. GET YOUR FICO SCORE: The FICO company created the formula that credit bureaus use to generate a FICO score. Every consumer's FICO scores are calculated from data from each of the three main credit bureaus. The scores take

into account your payment history, the amounts you owe, your length of credit history, your new credit, and the types of credit you have used, says Shon Dellinger, vice president of myFICO.com for FICO. After getting your credit reports, Cunningham recommends obtaining your credit scores. A single FICO score can be purchased at myFICO.com for about \$16. (FICO scores from Experian are no longer available through myFICO.com. Instead, Experian scores can be obtained through Experian.com or AnnualCreditReport.com.)

3. STUDY AND CHECK: Everyone—including the major credit bureaus—makes mistakes. But when it comes to credit scores, it's the consumer who pays for such screw-ups through higher interest rates. As a result, consumers need to ensure that everything

on time." If something comes up to force you to be late on a payment, contact the creditor beforehand, alert them to the problem, and see if they might be willing to work out an arrangement.

6. LOW BALANCES: Credit scoring systems also look closely at consumers' so-called utilization rates, which compare outstanding balances to total available credit, Griffin says. "The lower your balances are as compared to your limits, the better . . . because it shows that you aren't overusing the credit you have available," he says. "It also shows that you make cautious and wise decisions with regard to how you use your credit." So paying down balances on credit cards can improve your FICO score.

7. GET CREDIT ONLY AS NEEDED: Having credit cards can help

No matter what scoring system you look at, the thing that will most affect scores negatively is being late on your payments. So pay your bills on time.

included in their credit history is accurate by thoroughly examining their credit reports. "If you are a junior and your father is a senior who's got rotten credit habits, make sure that your report is distinguished from his," Cunningham says. Since a mistake may appear on one credit report but not another, it's best to examine all three of your reports. If you discover any incorrect material, contact the appropriate credit bureau for information about filing a dispute.

4. PAY UP, THEN ASK FORGIVENESS: In addition to correcting inaccuracies, it's important to take care of all unpaid bills that show up on a credit report. (Keep in mind, however, that paying off a collection account doesn't remove the stain altogether—it will remain on your credit report for seven years.) But if, for example, you find that you've inadvertently missed a payment on a credit card that you've paid on time for years, it's worth calling the company to see if you can work something out, says Keith Gumbinger of financial publisher HSH Associates. "If it's a hiccup in a long pattern of good payments, you might be able to have them clear that up," he says.

5. GOOD HABITS: Correcting mistakes and paying off old bills are important steps toward cleaning up past blemishes, but in order to build a strong credit profile, consumers will have to develop healthy credit habits going forward. After all, the best way to boost your credit score is to pay your bills on time each month. "Credit scoring is pretty complex, but what you need to do as an individual isn't very complicated to get the scores you need," says Rod Griffin, director of public education for Experian. "No matter what scoring system you look at, the thing that will most affect scores negatively is being late on your payments. So pay your bills

raise your credit score, as long as they are paid on time. But it's important not to go overboard. Opening a slew of new credit lines at once can drag down your credit score, says Dellinger: "The classic example there is opening a whole bunch of store cards." So make sure that you open new credit lines only when necessary.

8. DITCH THE DOCTORS: There are plenty of outfits that promise to restore your credit to tiptop condition—for a fee. But Cunningham warns against turning to these "credit doctors." "Anybody who says they can clean up your credit report cannot do one thing that you cannot do for yourself," she says. "We have people come to us all the time that have spent hundreds of dollars and end up very disappointed." Consumers seeking specific advice on rebuilding their credit can locate a certified credit counselor in their area by contacting the National Foundation for Credit Counseling, Cunningham says.

9. CREDIT COUNSELING: When a consumer with troubled credit arrives at one of the NFCC's nearly 850 locations across the country, a trained credit counselor will review the person's recent pay stubs, bills, and collection letters before explaining how to "priority pay" monthly obligations: paying off living expenses first, then secured debt—such as a car payment—and then using whatever cash is left over to service the remaining debt. The counselor may determine that a debt

management program is the best option to help the consumer get back on track. "And that is where the debt counselor negotiates with the creditor for a lower monthly payment, lower interest, stops late fees, and stops over-limit fees with the goal being that the consumer can continue to service his living expenses in full, while still addressing debt reduction," Cunningham says. ●



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