Good Credit Score Not Good Enough Anymore

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With historically low rates, many homeowners are watching closely for the right time to refinance their mortgages. Those with good credit may well recall being showered with praise by a mortgage broker during the initial purchase for that solid credit score.

A few years ago, a score of 620 or higher was good enough. That increased to 680 in early 2008. Then it jumped to 720 in April last year and 740 in August, says Rodney Anderson, senior managing partner of Plano, Texas-based Rodney Anderson Lending Services.

In the past, any score of 700 or higher would get a double thumbs-up from credit experts. Now, rate adjustments begin kicking in at 740, with every 20-point drop adding another adjustment.

In other words, many people who were taking pride in their credit habits either must pay significantly higher or try to make quick changes to nudge their scores upward. "What used to be great is now only good," says mortgage broker Todd Huettner, president of Denver-based Huettner Capital. Refinancing that would have worked a year ago might well not make sense, he adds.

"I have clients all the time who literally wind up with a score of 739, 719, 699, 679 ... and it costs them money to either fix it or pay for it," Huettner says.

One of Huettner's clients, who always had a score of about 740, went to do a refinance and found her current score at 719. "The reason was, she put a new washer and dryer on a store credit card," he says. Many store cards are actually revolving credit, and your limit may well be equal or about equal to the purchase you're trying to make that day.

Take the application that Stamford, Conn.-based Luxury Mortgage Corp. got recently. Interested in lowering the rate on an existing mortgage, the borrower could verify substantial income, assets and personal credit history, says chief executive David Adamo. But the borrower's credit score had taken a hit after co-signing an auto loan for his son that had not been paid timely.

"As a result, the borrower, who otherwise met every other criterion, was unable to refinance the loan at a rate that made economic sense," Adamo says.

Another wrinkle in today's market: Even those with FICO scores of 740 or higher are penalized for buying in a geographic market on the downswing. "This adjustment affects all borrowers, regardless of score, if in a declining market," says mortgage broker Jim Heidelberg, president of Heidelberg Capital Corp. in Tampa, Fla.

In many cases, the added costs of rate adjustments are "enough to make a refinance that would otherwise make sense have no benefit to the borrower," Huettner says.

The road to new scoring

How did we get to this new reality?

The nation's two largest mortgage lenders, Fannie Mae and Freddie Mac, suffered major losses in the market last year and then redefined risk, announcing price adjustments for borrowers with FICO scores below 720, says Sean Cragg, vice president of sales for Ann Arbor, Mich.-based Gold Star Mortgage Financial Group.

And, in case you were wondering, "these fees have nothing to do with your mortgage company or its various products and cannot be negotiated away," Cragg says.

All mortgage bankers, brokers and credit unions must comply with the higher interest rates and delivery changes in all traditional mortgages, says Heidelberg. Only entities intending to hold the mortgages in their own portfolios can follow their own guidelines.

Worse news may be on the horizon. "There are many factors, including proposed legislation and regulation, that continue to change the mortgage lending landscape," says David Chung, managing director of Towson, Md.-based CreditXpert Inc., which provides credit analysis services to consumers. "In the near term, it is more likely that this benchmark will continue to rise than fall."

Surprise, surprise

Joe and Jane Homeowner have likely heard of the new credit restrictions. But the actual cost to them is often a surprise when they sit down with a broker.

"Often, lenders will quote rates that include the adjustments, without calling attention to them in order to avoid a negative reaction from their customer," says James Guthrie, a partner in New Home Finance in Suwanee, Ga.

Less surprising are other factors that go into securing financing for a new or existing mortgage. Paola Kielblock, national products manager for Sun Prairie, Wis.-based Fairway Independent Mortgage Corp., clarifies today's requirements:

• Good credit.
• Stable job, with a minimum of two years of employment.
• Reserves after closing, including a minimum of two to six months of mortgage principal, interest, taxes and insurance.
• Down payment from the borrower's own funds.
• Low debt-to-income ratio. The required ratio varies between banks but is generally less than 40 percent, according to many in the industry.
• Good loan-to-value percentage. It also varies, but it's often cited as less than 80 percent.

Having equity in your home is a major factor in getting approved for a refinance and in finding the best rate, says Cameron Findlay, chief economist for LendingTree.com. The more equity in the home, the less risk there is to the lender if the home is repossessed.

Taking action on your score

What can a homeowner who wants to refinance do with a good FICO score that's not good enough?

"Virtually everyone can raise their scores by at least 10 (points) to 20 points, sometimes significantly more in 30 days," Anderson says. Here's what to do.

1. Find out what might have gone wrong. Applicants should know their credit score, understand what it means to their loan rates and ask their loan officers to use credit analysis on their behalf, says Chung. Credit analysis tools are a simple way to identify key score influencers by scrutinizing the information contained in each of an individual's three credit reports to look for inconsistencies, errors and omissions that may artificially depress the score.

2. Correct any inaccuracies. Although consumers can improve scores on their own, Kielblock notes that credit agencies offer services to mortgage brokers to help consumers raise their credit scores if something is reported inaccurately and there is proof of a discrepancy.

3. Decrease the percentage of available credit used. This can be done by paying down balances or increasing credit limits, says Guthrie. Ideally, this means keeping balances as close to zero as possible, and definitely below 30 percent of the available credit limit, experts say.

"We've seen people increase their scores by as much as 90 points or more, simply by paying off the right cards," Anderson says.

4. Move things around. If one income can be used to qualify for the loan, transfer accounts to "park" the debt in the other party's name, Guthrie says.

5. Get a rapid rescore. It's the only way to find out fast if an attempt to improve a score was successful. It's done through your lender and a rescoring company. The process takes about a week, but it can get the loan process back on track. The downside is it costs a few hundred dollars. The credit bureau Experian has seen an increase in rapid rescoring requests, says spokeswoman Cynthia Baker. "While we haven't done a direct cause-and-effect analysis, anecdotally, the volume does appear to have increased as interest rates have dropped in March," she says.

Aside from working toward a better score, there are two additional options. One is paying points to buy down the interest rate. "This is only a good idea if the borrower will then live in the house beyond the break-even point, meaning the time where the money they've paid in points is made up for by way of less expensive monthly payments," says Findlay.

The other option: shopping around. Some lenders, such as Palo Alto, Calif.-based Addison Avenue Federal Credit Union, have loans, known as "portfolio" loans, that aren't subject to blanket rules on credit scores because the lender intends to keep them rather than sell the loans in the secondary market.

Michelle Edwards, national mortgage sales director, reports that for these loans, her company increases the cost of a mortgage only for consumers whose credit scores are below 680. One customer looking to refinance avoided a pricing adjustment because of compensating factors such as loan-to-value ratio, assets and length of employment.

In a perfect world, anyone contemplating a refinance or a new mortgage anytime within the next year or so would start working on getting the ideal credit score now.

But what if that didn't happen? Try not to let your emotions drive how you feel about your interest rate. A mortgage is a financial decision that should be driven by economics, "not the pursuit of the world's lowest rate because having it would make you feel good," Heidelberg says.

He also says some consumers wait six months for a slightly better rate when a refinance could save $500 a month means missing $3,000 in savings. As Heidelberg says,

"This is foolish."