

The Home Buyer's Guide to **Mortgage & Credit**

A quick-reference guide to credit, mortgage and buying a home.

With an A-to-Z
glossary of mortgage
and credit terms!



Home Buyer's Guide to Mortgages and Credit

A quick-reference guide to credit, mortgage and buying a home.

Please note: The information contained in this guide is for educational purposes. At the time of writing, the information was accurate. But in time, changes in market conditions, legislation and other external factors will inevitably render parts of this guide outdated. Use this information as a solid platform from which you can learn more about the topics covered. Always verify this information against your current local laws and conditions. Always seek the advice of a professional advisor before making important financial decisions.

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About Your Credit

What is Credit?

In home buying and mortgage terms, "credit" usually refers to your credit score. Your credit score is a numerical "grade" between 300 and 850. The higher the score, the better. This credit score is based on your credit report, which is basically your credit history on paper.

To summarize:

You credit history → [leads to] → Your credit report → [leads to] → Your credit score

Credit reports are maintained by three credit agencies: Experian, Equifax and TransUnion. These agencies maintain any and all information pertaining to your personal credit — payment habits (including late payments), bankruptcy and other issues.

Your credit score is based on the information in your credit reports, which come from the three aforementioned agencies. The agencies sell your credit report to banks and other creditors so they can review your past credit history.

Three agencies, three reports, three credit scores ... all about you!

How's Your Credit?

Before you begin house hunting or applying for loans, you need to take a good look at your credit situation. Try to do this a few months before beginning your home search to prevent delays later on. Start by ordering copies of your credit report.

Get copies of your credit reports from all three agencies and review your scores. Fair Isaac's (the organization that actually converts your credit reports into credit scores) has a website where you can order all three credit reports at once: www.MyFICO.com. Here's a quote from the home page of that website:

"FICO scores are your credit rating. Most lenders base approval on them. You have three FICO scores, one for each credit bureau, and you can only get all three from myFICO."

The MyFICO website also explains how to interpret your credit score, what the score means to lenders, and what you can do to improve your score. Don't be surprised if you find an error. It happens from time to time. To correct an error, contact the reporting agency directly. And don't delay — it may take several months to completely correct the error and remove it from your report.

How to Maintain Good Credit

When it comes to credit, an ounce of prevention is truly worth a pound of cure. In other words, you should focus on maintaining good credit at all times. That way, when you're ready to apply for a mortgage loan, you won't have any unpleasant surprises.

Being labeled "sub prime" or "bad credit" by a mortgage lender can make the loan approval process more difficult (see "Buying a Home with Bad Credit" on page 19). So you should do everything possible to keep your credit score high.

There are no quick fixes with credit — only things you can do over the long term. Here are some things you can do to keep your credit score high:

- 1. Pay your bills on time.** This means all your bills: credit cards, auto loans, etc. Paying bills on time will raise your credit score. Having a history of late payments will lower your score and cause problems.
- 2. Keep credit card balances low.** Don't let your credit balances get away from you. This will increase your overall debt, which will in turn elevate your debt-to-income ratio (see next item).
- 3. Keep your debt-to-income ratio at 20% or lower.** In other words, your overall debt should not total more than 20% of your net monthly income. If it does, focus on paying down the debt as quickly as possible.
- 4. Always pay at least the minimum amount.** If you can afford to pay more than the minimum amount due on credit balances, by all means do so. This will reduce your balance quicker and give you a more favorable debt-to-income ratio. At the very least, pay the minimum amount due. Paying less than the minimum will generally lower your credit score.
- 5. Limit the number of loans / accounts you apply for.** If you apply for credit too often, it could raise a red flag that you can't manage your finances. Use credit and loans sparingly ... only when you need them.