Mortgage Tips

Improving your credit score & saving for a downpayment

Improving your credit score

Credit scores help lenders determine how much risk you are. The higher your score, the less risk they think you will be. Your credit score compares your credit performance to that of similar consumers. FICO scores range from 300 to 850. Here are some tips to help you improve your credit score so that you have the best options for financing your home.

Check your own credit report: To obtain a copy of your report, visit www.annualcreditreport.com or call 1-877-322-8228. Review your reports from all three credit bureaus annually as well as several months before applying for a loan. Request reports from Equifax, Experian, and TransUnion because each bureau may have different information; mortgage lenders often look at all three FICO scores.

Correct mistakes: Your credit score is only as good as what shows up in your credit report. Dispute inaccuracies by enclosing supporting documents in a letter to the bureau.

Always pay bills on time: Your payment history is the single biggest factor in a credit score, accounting for about 35%. Since recent history carries more weight than what happened years ago, making on-time payments is a powerful way to rebuild your credit. Contact your creditors for payment arrangements to keep late notations off of your credit reports.

Keep your credit card balances low: Pay off debt, don't move it around. Owing the same amounts, but having fewer open accounts, can lower your score because lenders look at the total amount of debt you have in comparison to the total amount of credit available to you. The more debt you pay off, the wider that gap and the better your credit score. Keep your balances below 25% of your limit. Another way to keep a healthy balance-to-limit ratio is to charge less.

Do not close unused accounts: A credit card with a zero balance might help your score. Closing credit accounts lowers the total credit available to you, which would increase your balance-to-limit ratio and, therefore, lower your credit score. Plus, closing an account does not necessarily remove it from your report and it may be considered for scoring purposes.

Do not apply to open multiple accounts at once: No matter how tempting those pre-approved credit card offers are, adding accounts too rapidly sends up a red flag that you might not be able to handle your credit responsibly. In addition, a new account will lower the average age of your accounts, which is another factor in your FICO score.

Saving for a downpayment

Here are some tips on how to tap into your resources and budget your finances to save for your downpayment. The more money you have for a downpayment, the more choices you will have when negotiating your mortgage.

Keep track of your finances and cut-back on non-essential spending: Write down your monthly income, savings, and spending. Even a couple bucks for your daily Carmel Macchiato at Starbucks adds up. So instead of spending money on the small stuff, put that into your savings. Open a savings account specifically for the downpayment. Calculate how much you can afford to contribute to this account and arrange to make regular deposits.

Pay off your debt: Don't focus solely on saving for your down payment at the expense of paying interest charges on credit cards. The interest rates on these loans are much higher than the average rate for a home mortgage, meaning you are actually wasting money by accumulating a larger downpayment while carrying credit card debt. Also, realize that the amount of debt you already have will determine how much you can borrow for your home. After minimum payments, start with the card with the highest interest rate and pay as much as you can. You'll be amazed how much money you can put into savings once it is not paying for interest on credit card debt.

Make your savings work for you: Rather than saving all of the money yourself, let what you've already saved earn you interest at the best rate possible. What about CDs? Talk to your banker about the best investment option for you.

Use special programs: There are many programs for homebuyers in downpayment distress. Borrowers in a wide range of incomes, locales and professional groups may have access to aid from Fannie Mae and Freddie Mac, the government-sponsored offices that buy mortgages and package them as investments. Some lenders and government agencies will let you buy a foreclosure with no down payment if you have good credit or if you have skills that you can use to increase the home's value. Various nonprofit and community groups, as well as state and county agencies, also lend a hand to buyers struggling to put money down on a home.

Use IRA funds: Tax laws allow you to use up to $10,000 in Individual Retirement Account funds as a down payment if you have never owned a house. If you are married and you both are first-time buyers, you each can pull from your retirement accounts, meaning a potential $20,000 down payment. You may have to pay taxes, but not penalties. Check!

Borrow from your 401(k): Consider borrowing against your 401(k) for the down payment. Unlike an IRA home-related withdrawal, you'll have to pay back any money you take out. Even though your account contributions were made with pretax money, your repayment will be made with after-tax dollars.

Make money on unwanted items: Have a garage sale or post items on eBay. Even little things add up!

Receive a gift: Tax law allows gifts of several thousand dollars a year to be bestowed without tax consequences to either the giver or recipient, and it is not limited to relatives. Check with the IRS to determine the gift-exclusion amount as it is adjusted annually to reflect inflation. If no one is in a position to give you the money, perhaps they will agree to co-sign a loan.