

## KNOW YOUR SCORE!

FEB 2007

Whether you are new to investing and just starting out, or a seasoned veteran of the real estate game, one of the most important components of qualifying for mortgage financing is the need for good credit. Good credit can provide you with more options and make your file look more appealing to the bank. Most borrowers know they need to be wary of their credit rating and many of them are aware that the banks have their own 'scoring' system. What they don't know however, is how that scoring system works and what they could do to make it better.

Virtually everyone in Canada who has received credit in their lifetime has a credit score. This is most commonly referred to as your 'Beacon Score'. The better your credit the higher your score. The credit bureau system was developed as a way for lenders to determine future risk based on past history. The premise is that the best indication of future behaviour is past behaviour. Obviously this can present a few problems for anyone who has had a few 'bumps' along the road. If you have experienced a few blemishes in the past, the first rule of thumb is to draw a line and move forward with a clean slate. Like most things in life, you can't do anything about the past, but you can control the future.

The first thing to understand about your score is that it is a snapshot in time and is derived through a complex formula that takes a variety of items into consideration. Its purpose is to provide a lender with a prediction as to the credit risk of a client over the next 12 to 24 months. What the lender is looking for is not just a default or blemish on your credit, but rather a pattern of behaviour. Many people could easily have an isolated experience which can be explained, but it's a lot harder to explain a pattern of late payments on your Visa that show up every two to three months over a long period of time. The key is to understand how the score is derived so that you can learn how to improve your score.

Beacon and Empirica scores are used by the two major credit bureaus in the country, Equifax and TransUnion. The scores are derived from analyzing data from five different categories to track patterns and predict future activity based on past behaviour. \*

### Past Payment Performance – 35%

- The most obvious impact on anyone's credit is not paying your bills on time. The #1 issue for any lender to consider before they lend you any money is; "Will you pay me back in a timely manner?" Therefore past performance carries more weight than any other.
- The fewer late payments, judgments, liens or collections, the better.
- Late payments are time sensitive. More weight is given to recent ones as opposed to those two years or older. As the saying goes; 'Time heals all wounds' and this is true with credit history as well.


### Credit Utilization – 30%

- Low balances on several cards are better than high balances on a few cards.
- This actually runs contrary to what most of us would logically think but it is probably the single biggest area where people are inadvertently hurting their score.
- If you can't pay your credit cards off every month, then it is ideal to keep the balance at or below 30% of the available credit. But the most important thing to be aware of is that once you exceed 80% of the available credit on those cards your credit score is seriously impacted. So, in fact, it is better to have two cards with lower balances than one with a high balance.
- Having said that, access to too many cards can be deemed detrimental because the system will deem you a risk for being 'overexposed to credit'. Look for a balance.
- Paying down a credit card to below 80% of the allowable limit is also the quickest way to improve your score.

### Credit History - 15%

- The longer the accounts have been open and in good standing, the better.
- A 'red-flag' for lenders is opening new accounts to pay out old accounts – or 'credit surfing'. This will negatively impact a credit score. They don't like to see clients who are constantly 'surfing' for credit.

### Types of Credit in Use – 10%

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- Finance company accounts score lower than traditional banking or retail accounts.
  - This is another example of where a lot of clients are hurting themselves and not knowing it.
  - Deferred payment options funded by finance companies impact the score accordingly. Too many of these 'buy now, pay later' accounts could be interpreted as a potential for future risk.
  - Now at this point I want to caution you not to start losing sleep over your furniture payment at The Brick. Remember what I said earlier about the banks looking for a 'pattern'. If you have one or two 'buy now –pay later' items show up on your bureau, don't worry. But again, if this is a pattern and it shows up often, then yes, it may make perfect sense to you, but will be seen as a 'red flag' to a lender.

#### Inquiries – 10%

- Looking for new credit often can result in having too many inquiries on your bureau over a short period of time This will be seen as 'Shopping for credit' and can be indicative of higher risk..
  - This is probably one of the most frustrating reasons for damaging your credit. Many would think that it's a good idea to shop around at different banks to try to get the best rate. But every time you have a lender pull your credit it lowers your score. So keep inquiries to a minimum. \*(a key point to make here is that when you pull your own credit, it does not impact your score)
  - Promotional or administrative inquiries (i.e. credit grantor updates) will show on the report but do not affect the credit score.
- (\* Source: CIMBL Mortgage Journal / Fall 2004)

Having good credit is important to you so make sure you take the time to know more about yours and protect it.

Happy investing,

Peter Kinch