

Thinking of Buying Your First Home or Refinancing? Here's How to Improve Your Credit Before You Apply

While no one can count on rate forecasts, the prospect of lower mortgage rates later this year should have borrowers thinking about taking advantage of cuts if they happen.

The first step anyone should take is a regularly scheduled check of his or her credit report. The second is taking the necessary steps to improve any troubling aspects of their credit picture. Here's how to get started:

Schedule a visit with your financial planner or tax adviser – or both: You may be focused on all the money you're going to end up paying for a home or the cost of a refinance, but it's a good idea to meet with a tax professional or a financial adviser. Trained experts who know your overall financial picture can talk to you about your credit and how the biggest single debt of your life should be managed over time.

Set a credit report schedule: You have the right to get all three of your credit reports – from Experian, TransUnion and Equifax – once a year for free. You can do so by ordering them at www.annualcreditreport.com. Yet don't order all three at the same time. By staggering receipt of each of your credit reports at different points in the year, you'll get a continuous picture of how your credit picture looks. Also, you'll have the opportunity to focus on possible errors in a single report, which will give the other two credit agencies time to update their files.

Reform your late payment behavior: If you've failed to make on-time payments of credit card bills, car loans or your utilities, stop it for good. Nothing will sink a credit rating faster than lackadaisical payments. Do any of the following. First, get a calendar and when bills come in, mark payment days 5-7 days ahead of due dates so the U.S. Mail gets your payment in on time. Second, check out the electronic bill payment service at your bank—and program in payment reminders so you never forget to push that button. You can also use your creditor's electronic payment option, but pay a few days ahead at the start so you can see how quickly your payments are recorded (some electronic payment systems still delay recording payment by a day or two even if the debtor pays on the due date).

Get current: If you have missed payments on an account, do whatever it takes to get current and then never let yourself fall behind again. According to myfico.com, the longer you pay bills on time, the better your credit score.

Understand the real penalties of bad credit: It takes at least seven years to remove a collection account or a bankruptcy from your credit record, even if you've paid any amounts owed in full. Write down the exact month you settle a collection account or when your bankruptcy will leave your credit report and make sure those black marks leave your credit reports on time.

Get rid of balances in sequence: Pay off your highest-rate balances first. There's a temptation to move around outstanding balances if you get a good credit offer, but remember that when you have debt problems, the last thing you should do is open new accounts. It's fine after you fix the problem as long as you plan to pay off all balances quickly.

Before you do borrow, ask lenders which credit agency they use. If you know your credit is in good shape, this won't be a concern, but it always pays to ask a potential lender – particularly a mortgage lender – if there is one credit bureau they favor over others. It's important because you may have a significantly higher or lower credit score on one report compared to another.

Cut up unnecessary cards, but don't close the account: Closing accounts – even those that have had zero balances for years – is a bad idea. Lenders want to see a long record of credit management, and longtime accounts that you haven't touched in years may actually help your score because it shows you have some restraint.

June 2007—

This column is produced by the Financial Planning Association of Southern Wisconsin. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our CERTIFIED FINANCIAL PLANNER™ members.

CFP®, CERTIFIED FINANCIAL PLANNER™ and the federally registered CFP (with flame logo) are certification marks owned by Certified Financial Planner Board of Standards, Inc. These marks are awarded to individuals who successfully complete CFP Board's initial and ongoing certification requirements.