

Credit scoring has been utilized by lenders for over 20 years. A score is a scientific way of assessing how likely a borrower is to pay back a loan.

A Credit Score is based on the data available in the borrower's credit report and measures the relative amount of risk a potential borrower represents to the lender or investor. The most widely recognized score for the mortgage industry is the FICO, or Fair Isaac Score.

FICO Scores range from approximately 350 to 875 points, and are available from all three of the national credit repositories. **Each bureau calculates its score based solely on the data within that repository's individual credit file.** Each bureau also has its own name for its version of the FICO.

- Beacon - Equifax
- Empirica - Trans Union
- Fair Isaac - Experian

FICO Scores are calculated by a system of scorecards. In developing these scorecards Fair Isaac uses actual credit data on millions of consumers and applies complex mathematical methods to perform extensive research into credit patterns that forecast the likelihood that a consumer will make his or her loan payments as agreed in the future. FICO models at each bureau are of similar design and the scores are scaled to provide a similar degree of risk. A Beacon score of 680 represents the same relative degree of risk as a Fair Isaac score of 680. This risk is defined in the number of accounts that remain in good standing compared to those that default. Some sample ranges include:

- Below 600 8 good loans for each bad
- 700-719 123 good loans for each bad
- Above 800 1,292 good loans for each bad

Why has credit scoring taken hold in the mortgage industry? The primary force driving this relatively recent phenomenon is the endorsement given credit scoring by the largest mortgage investors in the United States, FNMA and FREDDIE MAC.

In mid 1995, both issued letters stating their verification of the use of credit scores was a valuable tool in evaluating credit risk. Both have endorsed certain "cutoffs". For example, both agreed that a FICO score less than 620 would indicate a need for a cautious, detailed review of a borrower's credit history in order to identify compensating strengths to offset the low credit score (high income).