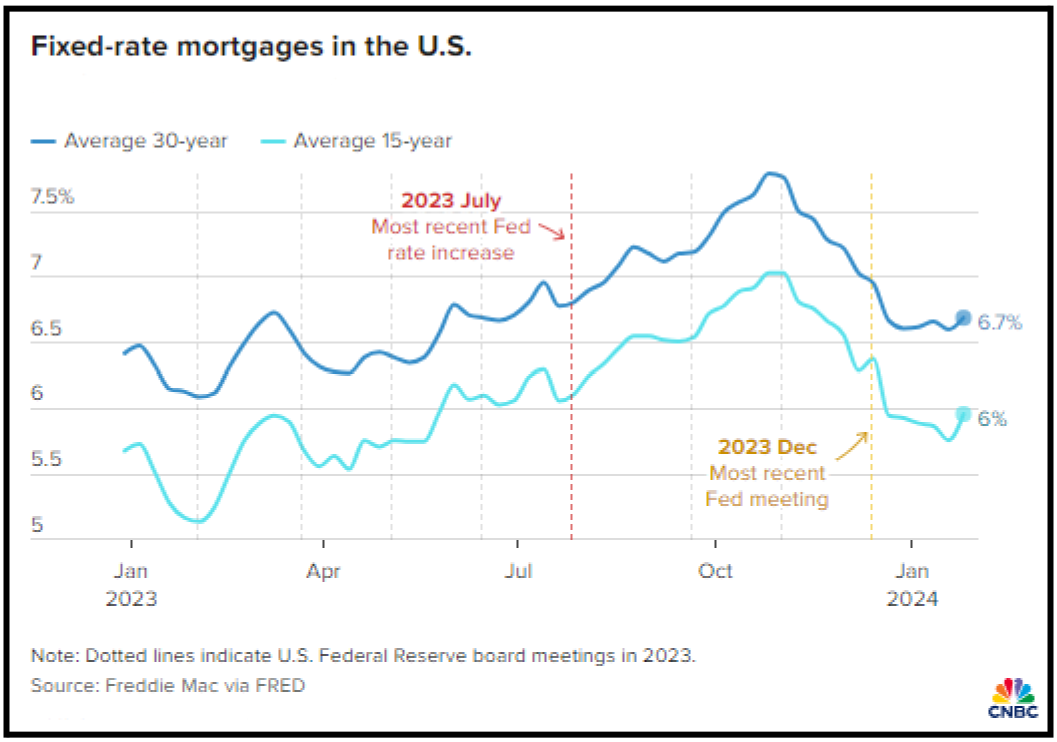
The Mortgage Rate You Get Depends Partly On Your Credit Score

Disclaimer: Always consult with a mortgage professional for advice and guidance regarding your credit score and obtaining mortgage financing.



KEY POINTS

- ❖ The average interest rate on typical 30-year mortgages has stayed between 6% and 7% for the last several months.
- ❖ The median home price in January was $383,000, which is about 1.5% higher than a year earlier.
- ❖ What to know about how your credit score affects the interest rate you can qualify for.

Anyone who's exploring homeownership may know that rising interest rates and elevated home prices are making that goal challenging.

The average rate on a typical 30-year, fixed-rate mortgage has been zigzagging between 6% and 8% for the last several months — hovering just over 7% in early November but roughly double the 3.3% average rate heading into 2024, according to Mortgage News Daily.

The interest rate that any particular buyer is able to qualify for depends at least partly on their credit score — meaning you have some control over whether you're able to get the best available rate, experts say. And the difference that a good or excellent score makes in terms of monthly payments — and total interest paid while you hold the mortgage — can be significant.

The national median home price in January 2024 was about $383,000, according to Redfin. Although prices have been sliding since mid-2022, that amount is still 1.5% higher than a year earlier. In January 2020, the median was below $300,000.

While you may be able to negotiate on the price of the house to bring the overall cost of homeownership down, it's also worth making sure you go into the process with as high a credit score as possible.

Lenders check three scores but use one number

Although things like steady income, length of employment, stable housing and other aspects of your financial life are important to lenders, your credit score gives them additional information.

The three-digit number — which ranges from 300 to 850 — feeds into a lender's calculation of how risky a borrower you may be. For example, if you've always made your debt payments on time and you have a low credit utilization (how much you owe relative to your available credit), your score will benefit.

And the higher the number, the less of a risk you are to lenders — and therefore the better terms you can get on a loan. Lenders check a homebuyer's credit report and score at each of the three large credit-reporting firms: Equifax, Experian and TransUnion. For mortgages, the score provided by those companies is typically a specific one developed by FICO, because it is the score currently relied on by Fannie Mae and Freddie Mac, the largest purchasers of home mortgages on the secondary market. (In the coming years, this reliance on one score is poised to change.)

However, because that particular FICO score can differ among the three credit-reporting firms due to differences in what is reported to them and the timing, mortgage lenders use the middle number to inform their decision.

Understanding your credit score

Credit scores help lenders determine eligibility for loans or credit.

Credit score ranges

300 - 659	660 - 719	720 - 779	780 - 850
Poor	Fair	Good	Excellent

Payment history (Most important)

Consistent, on-time payments

Delinquent payments

Credit history

Long and diverse credit history

Short credit history

Credit usage

Balances below 30% of your credit limit

High credit balances

Total balances

Pay down balances regularly

Outstanding debt

Credit checks

Limited credit inquiries

Multiple credit inquiries

Available credit

Adding more open lines of credit

Limited lines of credit

How are Mortgage Rates Determined?

Mortgage rates, in general, are determined by a wide range of economic factors, including the yield of U.S. Treasury bonds, the economy, mortgage demand and the Federal Reserve monetary policy.

Types of Mortgages

Good Financial CENTS

30-Year Fixed Rate	• Spread Payments Over 30 Years • Consistent Interest Rate and Payment
15-Year Fixed Rate	• Spread Payments Over 15 Years • Shorter Term • Higher Payments • Fixed Rate
5/1 Adjustable Rate (ARM)	• Initial Fixed Rate for 5 Years • Then Adjusts Based on Market Rates
7/1 Adjustable Rate (ARM)	• Initial Fixed Rate for 7 Years • Then Adjusts Based on Market Rates
FHA Mortgage	• Backed by FHA • Low Down Payment (As Low as 3.5%) • Easier Credit Requirements
VA Home Loan	• Insured by VA • Eligible Veterans Can Buy With Easy Credit • No Money Down

Borrowers have no control over the wider economy, but they can control their own financial picture to get the best rate available. Typically, borrowers with higher FICO scores, lower debt-to-income ratios and a larger down payment can lock in lower rates.

What's a Good Mortgage Rate?

Mortgage rates can change drastically and often—or stay the same for many weeks. The important thing for borrowers to know is the current average rate. You can check Forbes Advisor's mortgage rate tables to get the latest information.

The lower the rate, the less you'll pay on a mortgage. Depending on your financial situation, the rate you're offered might be higher than what lenders advertise or what you see on rate tables.

If you're hoping to get the most competitive rate your lender offers, talk to them about what you can do to improve your chances of getting a better rate. This might entail improving your credit score, paying down debt or waiting a little longer to strengthen your financial profile.

The higher your score, the lower the interest rate you'll be charged. For illustration only: On a $300,000, fixed-rate 30-year mortgage, the average rate is 6.41% (as of Thursday) if your credit score is in the 760-to-850 range, according to FICO.

This would make your monthly principal and interest payment $1,878. On top of this amount typically would be property taxes, homeowners insurance and, if your down payment is less than 20% of the home's sale price, private mortgage insurance.

In contrast, if your score were to fall between 620 and 639, the average rate available is 7.99%. That would mean a payment of $2,201 (again, for principal and interest only).

Most of your monthly payment goes to interest at first
Because of how loans are structured, most of your monthly payment would go to interest at the beginning of the loan instead of toward the principal.

For example, if you started paying on that $300,000 mortgage next month with a rate of 6.41%, in two years you would have paid $39,600 in interest and just $7,438 toward the principal, according to Bankrate's mortgage calculator.

In comparison, a rate of 7.99% would mean that in two years, you would have paid $49,570 in interest and $5,455 toward the principal, according to the Bankrate calculator.

There are ways to boost your credit score

If you want to get your score up before applying for a mortgage, there are some key things you can do.

You should aim to pay your bills on time, keep your debts low and show that you can successfully manage a variety of types of credit over the long haul.

It's also recommended to check your credit report yourself, look for any errors and work to have those corrected as soon as possible — which you can do for free at annualcreditreport.com — before applying for a mortgage.

How your credit score affects mortgage options

CREDIT SCORE	LOAN TYPE	LENDER
740-850	All loan types and the lowest interest rates, and those putting less than 20% on a conventional mortgage qualify for the lowest PMI premiums	All lenders
700-739	Conventional loans, and some borrowers can qualify for jumbo loans	Fannie Mae or Freddie Mac-approved lenders, and lenders that make jumbo loans
620-699	VA-, and USDA-backed loans, conventional loans	VA-, USDA-, Fannie Mae- or Freddie Mac-approved lenders
580-619	FHA-backed loans with down payments as low as 3.5%	FHA-approved lenders
500-579	FHA-backed loans requiring 10% down payment	FHA-approved lenders