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New FICO Scoring Model Won't Matter for Mortgages

by [Advisor Voices \(http://www.nerdwallet.com/blog/finance/author/advisorvoices/\)](http://www.nerdwallet.com/blog/finance/author/advisorvoices/) on September 8, 2014 | posted in [Advisor Voices \(http://www.nerdwallet.com/blog/finance/category/advisorvoices/\)](http://www.nerdwallet.com/blog/finance/category/advisorvoices/)

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FICO, the leading credit score model used by lenders and creditors, announced the new FICO Score 9 model that will be released in the fall. The model will be the consumer [myfico.com \(http://www.myfico.com\)](http://www.myfico.com) site and possibly by car lenders and credit card grantors. The major change with this is how it accounts for medical debt collections.

Under the current models used by most mortgage banks, medical debt collections can be very damaging to consumer credit scores. Medical collections are a cause of credit score drops. A recent study by TransUnion (<http://transunioninsights.com/healthcarecostsurvey/>) revealed that 54% of insured individuals are confused about medical bills. Credit scores can drop hundreds of points from one collection, and most people do not understand how easily they can be put in a vulnerable position. Even small credit score drops could mean a difference of hundreds or thousands of dollars over the life of a 30-year mortgage or a complete rejection for a loan. There are various thresholds of credit score that offer applicants different interest rates and cost. Even a score off by one point could mean a change in pricing.

However, the new FICO score (<http://www.nerdwallet.com/blog/health/2014/08/08/new-fico-score-boost-credit-medical-bills-focus/>) will place less emphasis on this medical debt. People with medical collections that are paid off will see the biggest increase in their credit scores, and those with unpaid collections will see some damage on their report lessened. According to FICO, consumers who have only unpaid medical debts as major derogatory references could see a median increase of 25 points.

Even though this sounds great for people with medical debt, they will not be in the clear if they are looking for mortgage approvals. FICO's last version, FICO 8, released in 2008 and has only recently been adopted by a small number of lenders. To date, the majority of merged credit reports we view from mortgage banks use the FICO 4 model. Banks tend to be very conservative with lending, especially for large loans like mortgages. Just because a new score is out doesn't mean mortgage lenders will use it, and it is highly unlikely that banks will adopt a credit score that ignores unpaid collection accounts.

Those who are in the market to buy a home or refinance a mortgage must understand this difference because many may assume that if they wait until the fall, their credit scores will increase, and they will be approved for loans at lower interest rates. This could cause buyers and refinancing applicants to avoid fixing their credit only to be disappointed and frustrated.

Fannie Mae and Freddie Mac are still using the older versions of the FICO score models in their own underwriting software. Fannie and Freddie have not expressed any intention of changing to the newer, less conservative models but said they were confident in the tools they currently use.

Unfortunately, this will cause confusion in the fall. When ordering FICO scores from the consumer site, individuals have to be mindful that their new scores could be even more inflated than the scores from the FICO 8 version. Individuals must be aware the [myfico.com](http://www.myfico.com) model does not accurately reflect what mortgage lenders see.

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