Transcript

How credit scores affect interest rates

Let's say that we're interested in buying a house that would cost $300,000. You go to a lender and they say, "Well, as long as you put a down payment for 25%, we'll be willing to lend you 75% of this money." So you go out, scrounge up your savings and then you put 25% down. Twenty-five percent would be a fourth of $300,000, so you have a $75,000 down payment. And then you would have to borrow the remaining 75%, which is going to amount to $225,000, you're going to borrow.

What I want to do in this video is think about how much you will pay in interest depending on what your credit score is. This is only going to be a rough approximation – interest rates change, bank policies change. But it'll give you a sense of what the impact of a credit score can be.

So imagine you have a really great credit score. Let's think about this. Let's say that you have a really good credit score, let's say it's approaching 800. Let's say that it's even right at 800. In that situation, at least at the time that I'm doing this video, interest rates will change. You could get an interest rate on a 30-year fixed loan, so that means you're going to pay the same amount every month and it's going to slowly pay down the principal, and over 30 years you will have paid off your house. The house will be all yours.

So with a credit score of 800…so let me write this down. So with a 30-year fixed loan, you could get it for, I looked this up on some of these calculators here, you could get it for 3.765% on a 30-year fixed loan. If you did that for $225,000, your monthly payment would come out to be $1,044.

Now let's think about what would happen if you had a not-so-great credit score, but still a score good enough to get a loan. So not great, but not an absolutely horrible credit score. So let's imagine a credit score that is in the low 600s. So let's say that you have a credit score of 630. Based on the information that I found, with a credit score of 630, you're going to pay a dramatically higher interest rate. You're going to pay above 5% in interest. And what I've looked up is 5.354% seems to be what the current information is. And once again, these will change over time, depending on interest rate conditions and depending on how credit is perceived, etc., etc.

And you might say, "Hey, that doesn’t look like a huge difference. That’s not even a 2% difference."

But it becomes very clear when you look at your monthly payment. The monthly payment when you’re paying 5.354% is $1,257. So you’re paying over $200 more per month. You’re paying about 20% more per month. And if that doesn’t kind of shock you, you know – "Wow, I could lease a car for that amount!" Just based on this, it wouldn’t be a fancy car, but you could do a lot with $200 a month. If that doesn’t kind of hit you as a major dramatic difference, you could think about the total interest paid over the life of the loan.

So obviously, or as we’ve talked about in other videos, as you start paying your loan, you’re paying mostly interest, because you have a large balance. And then as that balance – every payment, part of it

is interest, and then part of it is principal. As the principal pays down, more of your payment goes to principal and less of it goes to interest. But your total interest over the life of the loan is pretty telling, just based on this difference between credit. For this interest rate on a $225,000 loan, your total interest is going to be a little over $150,000. $150,813.

While with the lower credit score, your total interest over the life of the loan is going to be $227,517. So you’re going to pay more than $70,000 more, just because of this difference in your credit score. So hopefully this highlights the importance of really trying to make sure your credit score is as high as possible, especially if you’re going to undertake some type of major loan like a home mortgage.