Make The Most Of Your Credit Score

KOFE

Knowledge of Financial Education

A product of CONSOLIDATED CREDIT™

When debt is the problem, we are the solution.

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What is a Credit Score?

A credit score is a number that is used to predict risk for lenders. To create a credit score, analysts use information in credit reports, account histories, or applications. Their goal is to accurately identify the consistency of your timely paid accounts, as well as your delinquent accounts. The results of all this computing and analyzing, is a number that is your credit score.

Lenders use credit scores to help decide:
- Whether to issue a new account or loan.
- Whether to change the credit limit on an existing account.
- What interest rate to charge on a new or existing loan.

Insurance companies use insurance scores (which are based on credit information, but calculated somewhat differently) to help them decide:

- Whether to issue new auto or homeowner's policies.
- What rate to charge for those policies.
- Whether to renew existing policies. Some employers use consumer scores (which are also based on credit information) to help them make hiring decisions.

There are different types of scores; Fair, Isaac and Company, Inc. develops many of them. These are commonly referred to as "FICO scores." It's important to understand that your credit score is never a single number. It can vary; depending on which of the three major credit bureaus supplied the credit information used to calculate it, what kind of loan is being considered, and what formula the individual lender uses to calculate it.

For example, mortgage lenders typically request a "tri-merge" credit report, which includes credit information and scores from the three major credit bureaus -- Equifax, Experian and Trans Union. Typically the credit score from each of those bureaus will vary so the lender will use the score that falls in the middle of the three when evaluating the loan.

Keep in Mind:

- Your credit score can change frequently as information is updated in your credit reports.
- Lenders may use different credit scoring formulas that are customized for their loan products when calculating your score.
- Credit scores are calculated using the information in your credit report, even if that information is not correct.

With a FICO score, the higher the number, the better the score. For example, a score of 700 is much better than a score of 600.

What's In a Credit Score?

There are five categories of factors that go into your credit:

Payment history 35%
Amounts you owe relative to your income 30%
Length of credit history 15%
New credit 10%
Type of credit in use 10%

The two most important factors that go into your credit score are your payment history (have you paid your bills on time?) and the amounts you owe (how much debt do you carry?).

Together, these categories make up about two-thirds of your credit score. That means if you want to improve your credit score focus on paying your bills on time and paying down debt. If you are having difficulties paying down your debt on your own, contact a credit counselor for free advice at 800-210-3481.

How Can I Get My Credit Score?

You can usually purchase your credit score when you order your credit report, either through one of the major credit bureaus or through an online service that sells credit reports and scores to consumers. You can receive free credit reports annually by logging on to www.annualcreditreport.com.

It's an excellent idea to check your credit report and find out what your score is at least 3 months before a major purchase such as a home or car, to give yourself time to correct any mistakes or problems. Or you can contact the agencies directly:

Equifax
Equifax Credit Information Services, Inc.
P.O. Box 740241
Atlanta, GA 30374
1-888-766-0008
Web site: www.equifax.com

Experian
National Consumer Assistance Center
P.O. Box 2002
Allen, TX 75013
1-888-397-3742
Web site: www.experian.com

TransUnion, LLC
Consumer Disclosure Center
P.O. Box 1000
Chester, PA 19022
1-800-888-4213
Web site: www.tuc.com

How Long Will Negative Information Hurt My Credit Score?

- Late payments can generally stay on your credit report for seven years.

- Collection accounts and charge-offs can be reported for seven years from the date you first fell behind leading up to the collection account or charge-off.

- Bankruptcies may be reported for ten years from the date of filing, though the major credit bureaus will remove Chapter 13 bankruptcies (where you pay back some of your debts) seven years from the date of filing.

- Unpaid tax liens may be reported for fifteen years or longer. Paid tax liens may be reported for seven years.

Keep in mind that the older negative information becomes, the less of an impact it may have on your score; and new positive credit references can help improve your score, even if your credit report still contains negative information. That's why it is important, if you've had credit problems in the past, to establish positive credit references to boost your credit score.

That does not mean you should carry debt. If you can't qualify for a regular credit card, for example, you may be able to get a secured MasterCard or Visa, which requires a security deposit. Use it from time to time for purchases you would make anyway and then pay the bill in full to avoid interest charges.

How Much Can A Poor Credit Score Cost?

Your credit score will likely be a factor in the interest rate you are charged for loans. Here's an example:
A 4-Year Auto Loan for $20,000
Excellent Credit Score (700 – 800): $2,128 in total interest
Poor Credit Score (590 – 619): $6,919
In this example, the difference between an excellent credit score and a poor one is $4791 in interest!

Should I Close Old Accounts?

Many consumers who review their credit reports find old credit card accounts they haven't used for years still listed as open accounts. You may think it's a good idea to close those accounts and have them listed on your credit report as closed. That's not necessarily the case. Fair Isaac Co. says that closing old accounts can't help your FICO credit score, and can only hurt it.

Why?

Credit scores are based on information about how you've handled different types of credit over time. When you close out a lot of accounts, you may limit some of the information that could be helpful in predicting how you'll pay in the future. You may also shorten the average length of your credit history. When it comes to credit scores, a longer credit history is better.

Unless you have a specific reason for closing accounts — you're getting divorced for example, and want to close your joint accounts — you may want to leave your old accounts as they are.

Credit Inquiries

Anytime a lender, creditor or employer checks your credit report, an inquiry is created. Although the number of recent inquiries is not a major factor in a credit score, too many inquiries in the last six months to a year can negatively impact your score so it's best to avoid applying frequently for new credit.

The following types of inquiries do not hurt your credit score:

- Consumer-initiated inquiries, which occur when you order your own credit report or score.
- Promotional inquiries, which are created when your file is reviewed for a pre-approved credit card or line of credit.
- Employment or insurance related inquiries.
- To avoid penalizing consumers who shop for mortgages

or car loans, inquiries for these types of loans within a short period of time are grouped together and often count as a single inquiry. There is no such buffer, however, for inquiries generated by applying for credit cards.

How Will Credit Counseling Affect My Credit Score?

Many people worry that their credit will be damaged if they enter a debt management program through a credit counseling service. In fact, their credit score may actually improve if they successfully stick to the repayment plan.

There are several reasons for this:

- Fair Isaac Co., creator of the widely used FICO scores, does not consider the fact that a consumer is in a counseling program when calculating a credit score.

- Many creditors will not report anything to the credit bureaus that indicates that an account is being repaid through a counseling agency.

- Some creditors will "re-age" accounts that are behind when a consumer enters a counseling program and sticks with it for several months. That means the late payments immediately prior to beginning the counseling program may be removed.

- By entering a credit counseling program you may avoid further late payments, credit problems and even bankruptcy – all of which can significantly hurt your credit. If you successfully pay down your debt through a counseling program, your credit score can improve since the amount of debt you carry is one of the major factors in calculating a credit score.

Notes

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