MAKE THE MOST OF YOUR CREDIT SCORE

What is a Credit Score?

A credit score is a formula that is used to predict risk for lenders.

To determine a credit score, analysts use information in credit reports, account histories, and credit applications. The goal is to accurately identify the consistency of your paid accounts, as well as your delinquent accounts.

The result is a number that is your credit score. It basically assesses your creditworthiness, and whether you are a risk as a borrower for a lender.

Lenders use credit scores to help decide:

- Whether to issue a new credit card, account or loan
- Raise the credit limit on an existing account
- Set or adjust the interest rate of a new or existing account

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 TransUnion. Typically, the credit score from each of those bureaus may vary. The lender will use the score that falls in the middle when evaluating you for a loan.

Keep in Mind:

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

What's in a Credit Score?

There are five factors that go into calculating your credit score:

Payment history: 35%

Credit utilization: 30%

Credit age: 15%

New applications: 10%

Types of credit: 10%

The two most important factors that go into your credit score are payment history (have you paid your bills on time?) and the credit utilization (how much debt do you carry?). Together, these categories make up about two-thirds of your total score. That means if you want to improve your credit score, focus on paying your bills on time and minimizing debt.

Payment History

Your payment history is defined by whether you make your payments on time. Late payments negatively affect your score, so you should pay at least the minimum required payment every month. It's best to pay off your whole balance.

Credit Utilization

You can calculate your credit utilization ratio by dividing the total amount you owe on your credit cards by the sum of your total credit limits. If this percentage is over 30%, it can hurt your score.

Length of Credit History

The longer you've had credit, the more positively your score is affected. This is why it's sometimes better to leave old accounts open rather than closing them when you no longer need them. We will discuss this more later.

Credit Inquiries

Anytime a lender, creditor or employer checks your credit report, it creates an inquiry. Too many inquiries in the last six months to one year can negatively impact your score, so it's best to avoid applying too 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
- Inquiries when you work with a credit counselor

To avoid penalizing consumers when shopping for mortgages or auto loans, inquiries for these 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 or personal loans.

Types of Credit

Creditors like to see varied types of credit and loans in your file. For example, just having one credit card doesn't look as good as having a credit card, a mortgage, and an auto loan (all in good standing, of course). This is also sometimes called your "credit mix."

Marcie's Story: Remembering Credit Utilization

When I was younger, I got a few credit cards with low credit limits. They were all below $1,000. I charged nearly the whole limit every month. My rent was really high, and I had to keep buying supplies and clothes for my two growing toddlers.

Luckily, I had a high-paying job that helped me pay off every card in full every month. I figured I had nothing to worry about when it came to my credit score since I wasn't even carrying over a monthly balance.

I didn't check back in on my credit score until I as trying to get a mortgage for my new home. My score was nowhere near as high as I thought it would be, and I had no idea why. It wasn't until I learned *about credit utilization ratio that I realized my credit mistake. I should have asked for a higher credit limit, or at least made multiple payments per month.*

***Moral of the Story**: Pay attention to your credit limits compared to how much you are charging. Credit utilization makes up 30% of your credit score!*

Different Types of Credit Scores

FICO

FICO stands for Fair Isaac Corporation. This is the company that created FICO credit scores, which are used by over 90% of top lenders. With a FICO score, the higher the number, the better the score. The following table breaks down the categories of FICO scores.

FICO SCORE	RATING	WHAT IT MEANS FOR YOU
<580	Poor	Creditors will likely deny your applications.
580-669	Fair	You may have some trouble applying for lines of credit; interest rates will be higher.
670-739	Good	Most lenders will extend credit to you.
740-799	Very Good	You're above average and lenders assume you are credit worthy.
800+	Exceptional	Lenders consider you to be an exceptionally dependable borrower.

FICO 8

Introduced in 2009, FICO 8 is the most widely used FICO score. When lenders evaluate your scores before they extend credit to you, they are most likely checking this score.

FICO 9

Introduced in 2016, FICO 9 made a few adjustments to the FICO 8 formula. For instance, medical debt collections do not negatively impact your credit score with FICO 9. However, it still isn't used as frequently as FICO 8.

UltraFICO

UltraFICO takes more factors into consideration when calculating a credit score. Savings accounts, Money Market Accounts, and your checking account can all link to this FICO score, hopefully raising it higher than your FICO 8 or 9 scores.

VantageScore

VantageScore is a slightly different scoring model than FICO. The mission behind this score is to provide a scoring model that fits more people. Where others may be excluded from traditional models because of their short credit history or infrequent uses of credit, VantageScore is there to provide an evaluation of creditworthiness. This is a scoring model created by the three credit bureaus.

VantageScore 3.0

Though it's not very popular with lenders, VantageScore 3.0 is often reported by credit monitoring applications. It can be good to check this if you're trying to raise your score, but don't count on it being accurate when you apply for loans or credit cards. For that, the most accurate score is still FICO 8.

VantageScore 4.0

This scoring model was introduced in 2017. It adjusts to fit the changing factors that credit bureaus put on credit reports. For example, tax liens are no longer recorded on credit reports. VantageScore 4.0 does not factor in tax liens.

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 or call toll-free **877-322-8228**, but it won't include your score.

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. You can also contact the agencies directly:

Equifax
Equifax Disclosure Department
P.O. Box 740241
Atlanta, GA 30374
Website: www.equifax.com

Experian
Annual Credit Report Request Service
P.O. Box 105281
Atlanta, GA 30348-5281
Website: www.experian.com

TransUnion, LLC
TransUnion LLC
Consumer Disclosure Center
P.O. Box 1000
Chester, PA 19016
Website: www.tuc.com

Jim's Story: Credit Building Gone Wrong

My car broke down in the middle of my last semester of college. I needed a new car, and fast. I took the bus for a while and looked around used car listings to see what was out there. I wanted to get an auto loan so I could finance the car, but I knew I didn't have much of a credit history. I figured I would apply for five or six credit cards and see if I could start building my score. Three of the creditors accepted my application and I started using the new cards.

After a few months of bussing it, I decided it was time to go to a dealership and get a car. Unfortunately, my credit score had tanked. I sent in way too many applications way too fast, and my plan backfired. I got an auto loan, but the interest rate was through the roof.

***Moral of the Story**: Too many hard inquires on your credit in a short period of time can hurt your score. If you're trying to build your credit, try a secured card or small personal loan instead.*

How to Improve Your Credit Score

Focus on the five factors that make up your credit score to start raising it. Here’s how:

1. **Payment history**: Make all of your payments on time, especially on high-interest credit cards.
2. **Credit utilization**: Know your credit limits and stay well below them. Consider making multiple payments per month to keep your credit utilization ratio low. You can also request higher credit limits, but this could cause you to spend more. Only do this if you are certain you won’t abuse it.
3. **Credit age**: There isn’t much you can do to improve this factor besides wait. To make sure you keep your credit age the way it is, avoid closing old accounts.
4. **New applications**: Avoid applying for too many new lines of credit in a short period.

5. **Types of credit**: Keep old accounts open. To build credit, consider taking a small personal loan or getting a secured credit card that you can easily pay off every month.

How Long Will Negative Information Hurt My Credit Score?

- Late payments (over 30 days late) can generally stay on your credit report up to 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

Keep in mind that the older negative information becomes, the less of an impact it may have on your score. 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, you may be able to get a secured card, which requires a security deposit. Use it from time to time for purchases you would make anyway and then pay the bill to avoid interest charges.

Carlos' Story: Credit Monitoring Gone Wrong

I was using a couple different credit monitoring apps on my phone so I could try to get my score up. I was doing everything right, and my score steadily rose. I went from "Fair" rating to a "Good" rating.

Then I checked my FICO score. I thought that's what I was checking the whole time on my apps, but it turns out the apps were only showing me my VantageScore. My FICO 8 score was actually lower than what the app had been telling me.

***Moral of the Story**: Lenders and apps can show very different scores. FICO 8 is the most widely used score While apps that track your VantageScore can be useful, don't count on them to be 100% accurate.*

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. FICO says that closing old accounts can't help your credit score and can only hurt it.

Credit scores are based on information about how you've handled different types of credit over time. When you close out of a lot of accounts, you may limit some of the information that could be helpful in predicting your future risk as a borrower. 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, such as getting divorced, for example, you may want to leave your old accounts as they are. Also keep in mind that a creditor may close your account if it is not active. Make sure to find small uses for old cards periodically to keep them open and active.

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 (at 5%)
- Poor credit score (590-619): $6,919 (at 15%)

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 complete the program. There are several reasons for this:

- FICO does not consider the fact that a consumer is in a counseling program when calculating a credit score
- 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 and may be removed
- By entering a credit counseling program, you may avoid further late payments, credit problems, or 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

It's important to note that any accounts you include in a debt management program will be closed when you complete the program. This can have some negative impact on a consumer's credit score if their score was high when they started the program. However, for most consumers, the overall impact of a debt management program is positive or neutral.