WHAT IS A CREDIT SCORE?

A credit score is a number between 300 and 850, which United States consumers are given based on their history of paying their debt obligations.

Generally, a score above 750 is considered excellent; a score below 600 is considered poor.

WHO ASSIGNS CREDIT SCORES?

There are three major United States credit-monitoring agencies:

- Experian,
- Equifax
- TransUnion.

Each company has its proprietary method to determine a consumer's credit score; however, they are all based on similar factors.

> ***TRIVIA -*** A credit score is also called a "FICO Score." The concept of rating consumers' creditworthiness was started by the Montana-based company "Fair, Isaac, and Company" and founders Bill Fair and Earl Isaac in 1956.

HOW ARE SCORES USED?

Lenders use credit scores as a quick method to assess a borrower's creditworthiness when extending credit or making a loan.

It is also common for Landlords to screen potential renters using their credit score. Requiring a high credit score to lease a home has become more common in recent years since new laws have been passed limiting the amount of a security deposit a landlord may collect.

HOW DO I GET MY CREDIT SCORE?

While many banks now provide credit scores for their customers for free, one of the best methods is to download the app Credit Karma, which will report the credit scores issued by Transunion and Equifax. While Credit Karma does not report Experian's score, all three scores are usually very close – so knowing two is sufficient.

WILL CHECKING MY CREDIT SCORE HURT ME?

No, a self check of your credit will not affect the Score – see below for the factors that do affect the score.

WHAT ARE THE TOP FIVE FACTORS THAT INFLUENCE A CREDIT SCORE?

1. **Payment History** **(accounts for 35% of your FICO score).** Payment history is the most crucial ingredient in credit scoring; even one missed payment can hurt your score. When considering new credit, lenders want to ensure you will repay your debt on time. Payment history accounts for 35% of your FICO® Score.

2. **Credit utilization** **(accounts for 30% of your FICO score)**. Your credit utilization ratio is calculated by dividing the total " Used Revolving Credit " by "Total Available Revolving Credit." This results in a percentage of 0 to 100%. The lower the percentage, the higher your score. This is a commonly overlooked factor by consumers and has a significant impact.

   To have a top credit score, credit utilization should be below 10%.

   Here is an example of how it is calculated:

Maria's Credit Cards	Used Revolving Credit	Total Available Revolving Credit	UTILIZATION RATE
Citibank - Mastercard	$500	$1,000	
TD Bank - Visa	$500	$1,000	
Wayfair	0	$1,000	
Amazon	0	$1,000	
TOTAL	$1,000	$4,000	25%

In the above example, the utilization rate was calculated.
$1,000 Used Revolving Credit DIVIDED BY
$4,000 Total Available Revolving Credit
= 25% utilization rate

CHALLENGE
What would be Maria's Utilization rate if she closed her Wayfair credit card?

What would happen to Maria's Credit Score?

When a Consumer closes an unused credit card, their Available Credit decreases; this often causes their utilization rate to increase. Once their utilization rate increases, their credit score will decrease.

3. **Average Length of Credit History** **(accounts for 15% of your FICO score).** The credit bureaus track how long each account has been open, including how long specific credit accounts have been established and how long it has been since you used certain accounts. The longer your history, the higher your score. Therefore, if you have had a credit card for a long time, consider that closing it might impact your credit score.

4. **Hard inquiries** **(accounts for 10% of your FICO score).** Credit Inquiries are divided into two types – soft and hard.

    - SOFT INQUIRY A soft inquiry is when a verification is made, but no debt or additional debt is being requested. This might occur when a landlord inquires or a consumer checks their credit. It can also happen if an employer makes a check, although employer checks on employee's credit scores are not allowed in some states.

    - A HARD INQUIRY occurs when a consumer applies for more credit or a loan. This happens whenever you apply for a credit card, car loan, or mortgage. It also applies when you have an existing credit card but request an increase in the credit limit. Regarding mortgage applications, in some circumstances, multiple applications made within 30 days do not trigger numerous hard inquiries, but that is up to the credit rating bureau.

Hard inquiries are recorded in your credit file and lower your score. Therefore, consumers should be careful and only allow a hard inquiry when they are ready to purchase. Generally, one or two hard inquiries per year are acceptable, but more than that can have an impact.

5. **Credit mix** **(accounts for 10% of your FICO score).** There are different types of debt; some are considered "good," while others are considered "bad."

    - **Revolving credit** is typically associated with credit cards but can also include some types of home equity loans. With revolving credit accounts, you have a credit limit and make at least minimum monthly payments according to how much credit you use. Revolving credit can fluctuate and doesn't typically have a fixed term.

    - **Installment credit** loans are when you borrow a fixed amount and agree to make a monthly payment toward the overall balance until the loan is paid off. Student loans and Personal loans are examples of installment accounts.

    - **Collateralized Loans** – Some installment loans are backed up with property, such as a car loan or a mortgage. These loans are often referred to as Collateralized Loans. This type of debt is seen as "superior" because there is something for the lender to take back in the event of a default. When a borrower pays off a collateralized loan, their score will decrease.

Lenders use this credit mix to understand past debt experiences and how you have handled them.

IS HAVING A GOOD CREDIT SCORE IMPORTANT?

Your credit score is only necessary if you need to borrow money or rent a property. However, if you have poor credit, it can take a while (six months to two years) to change because adjustments happen slowly as the above factors change. Therefore, it is prudent to watch your score and be sure it is at least in the 700 range. It can be corrected if you have a poor score, but it takes time.

HOW LONG DOES IT TAKE TO IMPROVE A CREDIT SCORE?

Certain factors, such as Credit Card Utilization or Hard Inquiries, can boost or lower a score rapidly- thus, in just a few weeks. Other factors such as payment history and length of credit take time, so count one to two years to move an inferior score to a great score.

WHAT OTHER FACTORS INFLUENCE MY CREDIT SCORE?

Late or missed payments, foreclosures, collection accounts, and charge-offs are all examples of negative information that can appear in your credit file. See foreclosure, bankruptcy, repossession, charge-offs, and settled accounts.

These typically indicate that you have defaulted on a loan and can be red flags for lenders looking to approve you for new credit. The effect negative information has on your credit score depends on your overall credit profile and what type of record it is. These records typically stay in your file for at least seven years and often up to a decade.

CAN MY UTILITY OR CELL PHONE PAYING HISTORY INFLUENCE MY CREDIT SCORE?

Your credit file does not automatically include service accounts, such as utility and phone bills. Historically, a utility account could only impact a credit score if you didn't make payments and the account was referred to a collection agency.

But this is changing. A new product called Experian Boost™† now allows users to get credit for on-time payments made on utility and telecom accounts for FREE. Experian Boost works instantly, allowing users with eligible payment history to see their FICO® Score increase in a matter of minutes.

WHAT IS THE DIFFERENCE BETWEEN A CREDIT SCORE AND A CREDIT REPORT?

A credit report does NOT give you a score but provides a list of all the debt relationships an individual has had over many years. It indicates if the borrowing relationship is open or closed, how much is due now, what the highest amount was borrowed, and whether the required payments were made on time.

HOW DO I GET A FULL CREDIT REPORT?

All Consumers are entitled to a FREE credit report from the three reporting agencies once a year. To obtain your report online, go to https://www.annualcreditreport.com.

This website will allow you to order any of the three reports – it is easy to use.
Or you can contact any one of the three credit agencies directly and request a FREE report:

Experian: POB 2002, Allen TX 75013 Ph: 1-888-397-3742. Web: www.experian.com

Equifax: POB 105873, Atlanta, GA 30348 Ph: 1-800-846-5279 Web: www.equifax.com

Transunion: POB 105281, Atlanta, GA 30348 Ph: 1-877-322-8228. Web: www.transunion.com

Handout 5.01 explains further some techniques you can use to manage credit reports.

Reviewing your full credit report is very important because that is the only way to see what the lenders are examining. A consumer will often find that a credit line was fraudulently opened under their name. Additionally, if couples have joint credit cards, the debt will be on both individual's credit reports.

WHAT SHOULD A PERSON DO IF THEY HAVE NEVER ESTABLISHED ANY CREDIT?

If you want to establish and build your credit but don't have a credit score, consider:

Get a secured credit card. A secured credit card can be used like a conventional credit card. The only difference is that a security deposit—typically equal to your credit limit—is required when signing up. This security deposit helps protect the credit issuer if you default and makes them more comfortable taking on riskier borrowers. Use the secured card to make small essential purchases, and be sure to pay your bill in full.

CAN HAVING A GOOD CREDIT SCORE SAVE MONEY?

A good credit score influences your borrowing rate when purchasing a home. The mortgage lender may adjust the interest rate based on your credit score. However, that is the only time it will result in monetary savings. Most of the time, you will be denied additional credit if you have poor credit.

SUMMARY – HOW CAN A PERSON IMPROVE THEIR CREDIT SCORE?

Improving your credit score can be easy once you understand why your score is struggling. It may take time and effort, but developing responsible habits now can help you grow your score in the long run. An excellent first step is to get a free copy of your credit report and score to understand what is in your credit file. Next, focus on what is bringing your score down and work toward improving these areas.

Here are some common steps you can take to increase your credit score.

1. Pay your bills on time. Because payment history is the most important factor in making up your credit score, paying all your bills on time every month is critical to improving your credit.
2. Pay down debt. Reducing your credit card balances is a great way to lower your credit utilization ratio and can be one of the quickest ways to see a credit score boost.
3. Make any outstanding payments. If you have any payments that are past due, bringing them up to date may save your credit score from taking an even bigger hit. Late payment information in credit files includes how late the payment was—30, 60 or 90 days past due—and the more time that has elapsed, the larger the impact on your scores.
4. Dispute inaccurate information on your report. Mistakes happen, and your scores could suffer because of inaccurate information in your credit file. Periodically monitor your credit reports to make sure no inaccurate information appears. If you find something that's out of place, initiate a dispute as soon as possible.
5. Limit new credit requests. Limiting the number of times, you ask for new credit will reduce the number of hard inquiries in your credit file. Hard inquiries stay on your credit report for two years, though their impact on your scores fades over time.

CHALLENGE

Can you determine your Credit Utilization Rate?

- Run your FULL credit report
- Add up the balances the report shows as due on all your credit cards.
- Add up the credit limits the report shows as available on all open cards.
- Divide the total balance by the total credit limit.
- Multiply by 100 to see your credit utilization ratio as a percentage.
- CHECK your numbers against what Credit Karma shows as your Utilization Rate – the app will give you the exact percentage