

YOUR CREDIT SCORE

A guide from <http://www.beatingbroke.com>



WHAT IS A CREDIT REPORT?

Think of a credit report as an overview of your financial situation. Most anyone that you do financial business with where they lend you money or finance a purchase for you is likely reporting:

- ◆ How much the loan is for
- ◆ How many payments you have left
- ◆ How long you've owed the money or had the account.
- ◆ What interest rate the account has
- ◆ And if you've been on time with your payments

The credit bureaus then take that information and compile it into one big database of people and their financial life. Whether you apply for a new credit line, a new car loan, a mortgage, or even want to rent a house, the business or person that you are applying to is going to pull a credit report on you. When they request the report, the bureaus take the information that the lender gives them (usually a name, address and social security number along with other identifying information) and pull every bit of information that they have in their database that matches what the lender sent them and compiles a report. The result is a report of all of your financial dealings along with your credit score (FICO score). Your credit report.

Your credit report has quite a bit of information in it. It will hold your Name, Social Security Number, Birth Date, Addresses, and even your employer information along with the financial information and any public record and collection items (liens, bankruptcy, loans in collection, etc...). It also will contain any inquiries to your report. Each time you request a credit line of whatever sort, and the lender requests your credit report, it creates an inquiry record on your report.



How is my information used?

Any good lender is looking for borrowers that will pay back their loan. If the borrower doesn't pay back the loan, the lender is out some money. For obvious reasons, that is bad. By requesting a credit report on the borrower, the lender gets a snapshot look at all of your financial dealings. By doing so, they can get a good understanding of a person's

- ◆ Stability (financially and otherwise)
- ◆ Ability to pay (current and future obligations)
- ◆ Collateral or cosigner (do you have either?)
- ◆ Ability to save (will you be living paycheck to paycheck or worse?)
- ◆ Character (How you treat your lenders/finances is a good indicator)

Looking at these factors (and your FICO score), the lender can/will form an opinion as to your risk. Depending on how risky he/she thinks you are, they may not even offer you the loan. Based on your risk, the lender will also adjust the interest rate on the loan he lends you. The following table illustrates how a \$25,000 auto loan paid over 36 months can be affected by the different rates that you might receive based on where your score lands. (of course, rates and ranges may vary by institution)

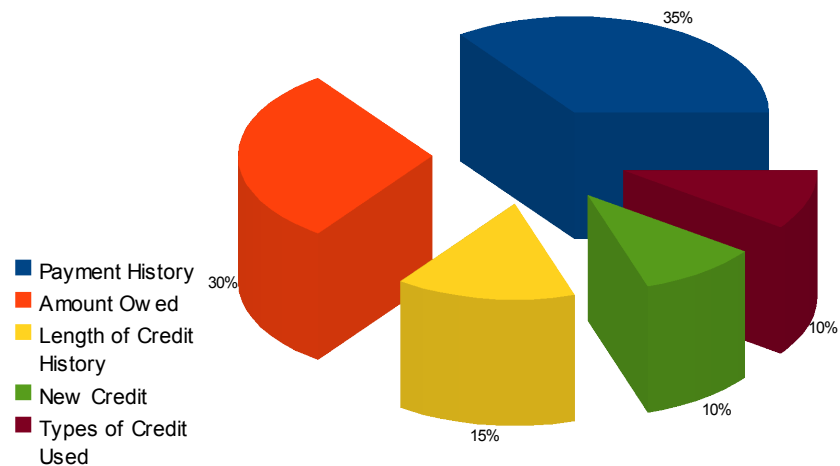
<u>FICO Score</u>	<u>APR</u>	<u>Monthly Payment</u>
720-850	6.312%	\$764
690-719	7.282%	\$775
660-689	8.831%	\$793
620-659	10.564%	\$813
590-619	14.158%	\$856
500-589	15.144%	\$868

WHAT'S A FICO SCORE?

The FICO score is based on a model first developed by Fair, Isaac, & Company in California. The score is broken down into several general categories that make up the full model.

- ◆ Payment History
- ◆ Amounts Owed
- ◆ Length of Credit History
- ◆ New Credit Requests
- ◆ Types of Credit in use

Each category is given a weighted value in the model and each item in your report can be scored using their formula.



Add it all up, and you end up with a range of 300 to 850. Each credit bureau will give you a FICO score based on the information they have on file for you. Not all three have the exact same information, so your score will vary from one to the other.

THE FICO CATEGORIES

Let's break down the FICO categories and take a look at the factors that effect each one. Knowing what these factors are is a great start on your way to mastering your credit score and taking complete control of your financial life.

Payment History

Payment History is the most heavily weighted of the FICO categories and is also the most complex.

- ◆ Account Payment information on specific types of accounts. This is your payment history. On time payments are very important.
- ◆ Adverse Public Records like bankruptcy, judgments, suits, liens, and wage attachments that would indicate a failure or inability to pay.
- ◆ Severity of Delinquency. How long did you let the payment lapse? The longer you waited, the worse it gets.
- ◆ Amount past due. Both on delinquent accounts and accounts that are in collections.
- ◆ Time since past due items, adverse public records, or collection items. Did you have a bad year 5 years ago? It's still on your record, but likely has less of an effect than if it were just last year.
- ◆ Number of past due items on file.
- ◆ Number of accounts paid as agreed. How many accounts have you paid off?

Amounts Owed

- ◆ Capacity. How much could you borrow at once?
- ◆ Amount owing on accounts.
- ◆ Amount owing on specific accounts. \$40,000 on a mortgage looks (and scores) much better than \$40,000 on credit cards.
- ◆ Number of accounts with balances.
- ◆ Proportion of credit lines used. Proportion of the capacity of your revolving accounts (credit cards, department store cards, charge accounts, etc...) to the total credit limits of the same type of accounts.
- ◆ Proportion of installment loan amounts still owing.

Length of Credit History

- ◆ Time since accounts opened.
- ◆ Time since accounts opened, by specific type of account.
- ◆ Time since account activity.

New Credit Requests

- ◆ Number of recently opened accounts, and proportion of accounts that are recently opened, by type of account.
- ◆ Number of recent credit inquiries.
- ◆ Time since recent account opening(s), by type of account.
- ◆ Time since credit inquiry(s).
- ◆ Re-establishment of positive credit history following previous payment problems.

Types of Credit

- ◆ Number of various types of accounts. How many credit cards do you have? Mortgages? Installment loans?

FICO FACTS

There are many factors that go into your credit score. Certain things have a more lasting effect than others. A bankruptcy, for instance, remains on your credit score for 10 years. Most other negative information will only remain on the report for 7 years. A single negative public record can drop your score by 65 points. And here are some other surefire ways to hurt your score.

- ◆ Late payments and negative public records based on recency, number, and severity.
- ◆ A low % of available capacity on revolving accounts, both individually by account and as a whole for all accounts.
- ◆ Closing a revolving account that you've had opened for a long time.
- ◆ Lowering the limit on a revolving account. This effects the available capacity % and can be detrimental.
- ◆ Multiple new accounts in a short time.
- ◆ Having loans at “second tier” finance companies. “Second tier” finance companies would be companies that administer a credit program for another institution. Department store cards are generally run by a “second tier” finance company.

THE ROAD TO A GREAT FICO CREDIT SCORE!

Using the information that you just read, you can make a dramatic change in your financial habits and make a huge difference in your credit score. Most importantly, make your payments on time, don't max out your credit cards, and don't apply for a new card every day (or even every week or month). Those three steps alone will make your credit score jump. It is also important to keep an eye on your credit report. Be sure to check for any negative marks like late payments and collection records on accounts that you may have forgotten about. Also check for open accounts that you have forgotten about. Maybe that old department store card that you opened freshman year of college to buy that dorm fridge?

If you do find any negative marks that shouldn't be there, you should contact the credit bureaus to correct it. They'll contact the reporting institution to verify the information's validity. If you're right, it's taken off your record and no longer counts against you. That could mean a double digit jump in your score! You can keep an eye on your report by getting your free credit report from www.annualcreditreport.com or, if you prefer a more active watching, through a program like [Equifax's Credit Watch](#) that charges a monthly fee, but you can look at your report and score anytime you wish.

FICO INFORMATION SOURCES

- ◆ www.myfico.com
- ◆ www.ftc.gov
- ◆ Equifax: 1-877-576-5734 www.equifax.com
- ◆ Experian: 1-888-397-3742 www.experian.com
- ◆ TransUnion: 1-800-680-7289 www.transunion.com
- ◆ Pre-Screen offer opt-out: 1-888-567-8688
- ◆ Get your free annual credit report:
www.annualcreditreport.com

For further reading, please visit www.beatingbroke.com!