# FACTS YOU SHOULD KNOW ABOUT YOUR CREDIT SCORE



MAKE A WAY MINISTRIES INC
Cornerstone Financial Counselors

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***The following information is provided without charge as an educational service to consumers who are interested in knowing more about credit scoring and the factors that affect their credit score.***

## Background Information

When a credit file is sold to a member, it contains a Credit Score that has meaning to a prospective creditor. At a glance, the creditor can determine the relative risk of granting you credit. This Credit Score was developed by the firm Fair, Isaac and Company and is known as the "FICO Score" (Equifax's version is called a "Beacon Score"). The score range is approximately 350 to 850. Therefore, the higher the score, the less of a credit risk you are. Further in this paper we will examine different scales for these scores and what they say about one's credit worthiness.

A crucial point to know about the Credit Score is that until recently, the credit file version the consumer had access to did not even include it. It was published only in the version given to bureau members. Therefore, the only way for the consumer to know the Credit Risk Score was to ask a prospective creditor who has reviewed the report. However, as of 2001 credit scores have become available to consumers by going on to the Fair, Isaac and Company web site – www.myfico.com. For a charge of less than $20.00 per credit bureau, you can now access your credit report which will contain your Credit Score. Each individual credit bureau, Equifax, Experian and Trans Union also has this availability on their web sites. If you are in the market for a new home mortgage or a car loan, it may be a good idea to find out your Credit Score before applying for the loan for a couple of reasons. One is to see if there are problems present which were not anticipated. This way the problems can be addressed before applying. The other reason is to make certain the creditor is offering you a fair rate for the score that you have. They may advise you that your score isn't quite good enough so they can charge a higher interest rate when in fact the Credit Score is more than acceptable. On the last page you will find a credit scoring scale that will be helpful in knowing how to gauge your particular score.

It is also possible to obtain one free credit report per year from each of the three credit bureaus. Simply go to www.annualcreditreport.com and download your reports. The free ones do NOT include your FICO scores and for a relatively low additional charge you can download your credit reports with your current scores.

## Main Factors That Determine Your Score

The calculations that make up a Credit Score are developed by looking at the way millions of consumers manage their credit. Credit Scores have proven over time to be a reliable indicator of whether or not a consumer would repay a loan. A score is determined by summarizing many factors in your credit report. The following are these factors along with approximations of how each are weighted according to Fair, Isaac and Company:

*Payment History (approximately 35% of score)* – How you paid your bills in the past gives the lender some indication of how you can be expected to pay them in the future. How often you have been late paying your bills, how recently your payments have been late as well as how long you remained delinquent on any bill at one time are important factors. For instance, being 90 days late will affect the score much more than being 30 days late. Generally late payments more than 2 years old don't impact the score as much.

*Outstanding Debt (approximately 30% of score)* – The lender wants to know proportions of balances to credit limits. In other words, they want to know how much credit you have and how much you have used. Research has shown that the number of credit accounts you have as well as how much of your available credit is used is important. If your total debt is more than 75% of your credit limit, your score is drastically reduced. It is best to keep the balance under 35% of the credit limit.

*Length of Credit History (approximately 15% of score)* – Generally, the longer you have had and have successfully managed credit, the higher your credit score. To be able to have a very high credit score, you will normally need to demonstrate at least 10 years of positive account history.

*Number of Credit Cards / Credit Inquiries (approximately 10% of score)* – The rule of thumb is that you need at least four revolving accounts (credit cards) to be able to have a good score. However, more than ten credit cards may lower your score. Applying for too much new credit is probably one of the easiest ways for people to inadvertently harm their credit scores. In that regard, too many inquiries in a short period of time signals a consumer is seeking credit because of a financial problem. The score will reduce with more than 3 inquiries in the last six months and 6 within the last year. However, the credit report data used to calculate credit scores does not include auto or mortgage loan inquiries that occur in the 30-day period prior to the score being calculated, and auto and mortgage inquiries that occur in any 14-day period are always considered one inquiry.

*Types of Credit (approximately 10% of score)* – A mixture of types of credit such as credit cards, personal loans, mortgages, etc. is more positive than having just a certain type of established credit. Typically, at least one “installment” tradeline (e.g. mortgage or auto loan) is necessary to have a high credit score. If you have indebtedness strictly with finance companies instead of bank credit cards, it will be a negative for your score because the perception is that you have had to go to high interest finance companies due to past financial problems.

## Additional Factors That Affect Your Score

There are also other factors that are taken into account when determining the score. These factors are somewhat related to the ones already listed but the amount that each one weighs in the scoring model is not known, Nevertheless they are important and should be considered:

*Unsatisfied Debt* – Old debt obligations that are in the form of collection or charged off accounts look worse than even a bankruptcy. This affects the score significantly as prospective lenders do not want to offer credit to someone who has the profile of not honoring their obligations. Also, if there is an unpaid debt of significance, mortgage lenders may not want to approve a loan if there is the potential of an additional lien holder who can utilize the court to obtain a judgment. Therefore it is always better to pay off an unsatisfied debt. A paid charge off or collection account will increase the score as opposed to just keeping the account unsatisfied. If the creditor is willing to offer a lump sum settlement in order to get a particular debt resolved, the remark on the credit report will most likely read "settled in full" which may cause the score to be lower than if the debt was paid in full.

*Zero Balances* – Research shows that consumers with no balances get lower scores than those with moderate balances. The reason is that lenders fear the consumer can go on a spending spree with the available credit and incur new debt. That is why if you practice never carrying a balance, which is certainly commendable, then having cards with moderate credit limits is recommended. However, if you pay off the credit card at the end of each month, the scoring models will pick up your charges but not the fact that you paid them off immediately. Therefore, you will want your charge balances to stay below 50% of your credit limits. Closing out cards that you never use will also help with the issue of too much available credit. Remember that it is better to close newer credit card accounts than older ones because you want to preserve the positive payment history.

*Balance Transfers* – Generally, four or more balance transfers over a 12-month period will lower your score. It is perceived that consumers who have to transfer balances use debt beyond their means. If you do transfer between accounts, you should close the old account and plan on staying with the new account for at least two years.

**Besides the information contained on the credit report, the score is also based on certain demographic characteristics such as:**

- Married is better than single with the most favorable age group being 25-65. Also, more than three dependents will tend to lower your score.

- Steady employment is a positive for the score especially after 6 years. Also, occupation is a factor with professionals getting the higher scores, skilled workers next and unskilled employees achieving the lowest scores.

- The score will be better if your are a homeowner as opposed to a renter.

- Income under $1,000 per month is a negative and over $3,000 a positive.

- The score will be better if you have a bank account and a telephone in your name.

## Credit Scoring Scale

The following is an example of a credit scoring scale that most lending institutions adopt in the approval process. Similar score ranges as shown play a significant part in determining the interest rate a lender gives:

Above 750 = Excellent
720 to 750 = Very Good (720 minimum score for Fannie Mae Mtg)
700 to 719 = Good
680 to 699 = Above Average
660 to 679 = Solid
620 to 659 = Fair (620 minimum score for FHA Mortgages)
600 to 619 = Marginal
580 to 599 = Below Average
550 to 579 = Well Below Average
525 to 549 = Poor
500 to 524 = Very Poor
Under 500 = Unacceptable

This article while informative is limited to the essential information about credit scoring. You can obtain additional information by purchasing the following publication from Make A Way Ministries:

***HOW TO RESTORE YOUR OWN CREDIT REPORTS AND SIGNIFICANTLY IMPROVE YOUR CREDIT RATING***

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