

COMPLETE GUIDE to CREDIT SCORES

WHAT IS A GOOD CREDIT SCORE?

A credit score is usually only one factor among several in a given lending decision. It's usually an important factor, but a lender may also weigh other criteria heavily as well.

Every lender sets their own criteria based on how much risk they're willing to assume and how much profit they think they can make, but, generally speaking, the higher the score the better.

Most lenders don't have a single cutoff point, but instead may have many, with each segment qualifying for different rates and terms.

The most common credit scoring system, FICO (from Fair Isaac & Co.), rates borrowers on a numeric system from 300 points to 850 - the higher the better.

Most American borrowers score 700 or higher on the FICO scale. Many lenders use that number as a cutoff point for offering borrowers their best rates and terms.

Companies that lend to borrowers below that level are often called "subprime" lenders because their risky borrowers are considered less than "prime."

Fair Isaac & Co. has recently created an updated credit scoring system that they call "NextGen." It has a wider range than FICO: 150-950. Your actual score, however, predicts about the same amount of risk in both systems. So, a 750 is considered low-risk under both FICO and NextGen.

THE FIVE MOST IMPORTANT FACTORS IN YOUR CREDIT SCORE

Each factor might weigh more or less heavily in your individual score, depending on your credit situation:

1. Your Payment History

This makes up about 35 percent of the typical score. According to Fair Isaac & Co., six out of ten Americans don't have a single late payment on their credit report. When it comes to negatives like late payments, the score focuses on three factors:

Recency – this is how recently the borrower was in trouble.

Frequency – this is how frequently the borrower has been in trouble.

Severity – this is how serious the trouble has been.

2. The Amount of Debt

This makes up about 30 percent of your score. Total amount owed is examined, as well as the different types of debt involved. Maxing out your credit limit, or even coming close, will inevitably hurt your score. The greater the difference between your credit balance and your limit, the better.

3. The Amount of Time You've Carried Credit

This is fifteen percent of your score. The longer you've had credit, the better. According to Fair Isaac, the average American has carried credit for fourteen years.

4. How Many Times You've Applied for Credit

This is ten percent of your score. The more times you've applied for credit in a short amount of time - without a long credit history - the lower your score. According to Fair Isaac, the average American hasn't applied for credit in the past 20 months.

5. The Variety of Your Credit

This is 10 percent of your score. Fair Isaac doesn't explicitly reveal what they regard as a positive credit mix, although they do say you don't necessarily have to have a loan of each possible type.

To get the best possible score, it's recommended that you have revolving debt, like credit cards, as well as installment debt, like an auto loan. Bank credit cards are better than store or finance company credit cards. According to Fair Isaac, the average American has four or five bankcards, and most have at least one installment loan.

HOW TO FIX YOUR CREDIT RATING FAST

There are a growing number of "rapid rescoring" services that offer to fix your credit in 72 hours or less. It's important to understand, however, that there are a number of things these services can and can't do:

1. They can't work directly with consumers. Instead, you'll need to work with a loan officer or mortgage broker who subscribes to an agency that offers this service.
2. They can only help if you have evidence that you've been wrongly scored, such as a letter from a creditor acknowledging that your payment was reported as late when it was actually on time. Sometimes rescorers can help obtain such proof, but that can add days or even weeks to the process.
3. They can fix legitimate mistakes, but can't resolve disputes. If you don't have proof, you'll have to deal with your creditor to solve the problem.
4. Even if they remove a mistake, they can't always help your score. Ironically, removing mistakes can sometimes even hurt your score by moving you up in to a higher scoring bracket, where you may be unfavorably compared to others in that bracket.

Rescoring typically costs \$50-\$100 for each account that's corrected, although some agencies provide the service at no cost as part of a package of services provided to lending professionals.

Rebuilding your credit rating can be a slow process, but there are a number of shortcuts:

Pay down your debt. That's the simplest way to lower your debt utilization ratio – the difference between how much you owe and how much credit you're allowed.

It's also possible to take out a 401(k) loan, but the risk is that if you lose your job you'll probably have to pay the loan back quickly or face taxes and penalties on the balance.

Never cash out a 401(k) loan or withdraw money from an IRA account to pay off credit card debt. The short-term gain isn't worth the long-term costs for premature withdrawal.

Don't dispute more than three or four negative items in your credit file at a time (unless they're related). A credit bureau could get the idea that your complaints are frivolous and might refuse to investigate.

While it's always a good idea to pay off old debts, you should make sure that the old account is dropped from your report as a condition of payment. Otherwise, the payment may make the negative seem more recent than it actually is, depressing your score.

BEST WAYS TO IMPROVE YOUR CREDIT SCORE

1. Start by ordering your credit reports from all three major credit bureaus and reviewing each one for accuracy.

You can get reports from a service like MyFico.com, or order from each bureau separately online or by phone:

- a) Equifax: www.equifax.com, 800-685-1111
- b) Experian: www.experian.com, 888-397-3742
- c) Trans Union: www.transunion.com, 800-888-4213

Check to make sure your identifying information is accurate. Any errors or inaccuracies may mean that somebody else's information is in your file.

Review your credit accounts. Make sure all the accounts belong to you. If there's any incorrect information, you may be a victim of identity theft. It's also possible that the credit bureau may have simply mixed your information up with somebody with a similar name.

Check to see who's made inquiries about your credit. If there are any inquiries older than two years, or credit application inquiries that you didn't authorize, dispute them.

Check to make sure that all records regarding bankruptcies, lawsuits, foreclosures, and tax liens are accurate. If there are any errors, dispute them.

2. Always pay your bills promptly. Any late payment can lower your score, but the good news is that most creditors wait at least 30 days before reporting it to a credit bureau.

If you want to make sure you're never late paying bills, there are a number of methods to help you out:

- a) Automatic payment allows a company to take money from your checking account.
- b) Recurring credit charges automatically charges your bill to your credit card.
- c) Online bill payment allows you to pay your bills automatically through your bank's website.

3. Pay down your debt. The lower your debt compared to your credit limit, the better your score:

a) Prioritize your debts by how close the balances are to the accounts' credit limits.

b) Avoid consolidating your debts. It's better to have small balances on a number of cards than a large balance on one.

c) In order to raise money to pay down your debt, you can hold a yard sale, trim your spending, and/or take a second job. Do whatever it takes to put a significant dent in your debt.

4. Keep credit cards and other revolving accounts open. Closing them just limits your available credit, which can hurt your score.

5. Don't apply for new credit unless absolutely necessary. Once you've established a solid credit history, applying for new credit can only hurt your score.

6. In order to establish credit, it's a good idea to have checking and savings accounts. They show lenders that you're financially responsible. They're also a way for minors to begin establishing a financial history, in preparation for a credit application.

7. Another way for minors to establish a financial history is by being added to someone else's credit account (as long as that person is responsible).

8. One more way to establish a credit history is to have a responsible person co-sign a loan.

9. A new method for gauging creditworthiness for people without credit histories that's been gaining popularity with lenders is to check nontraditional sources such as landlords, utility companies, payday lenders, check monitoring companies, and retail purchase payment plans.

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