

YOU and YOUR CREDIT: Credit Scores¹

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This is the fifth publication in the seven-part YOU and YOUR CREDIT series, which contains information about the skills and knowledge needed to obtain, understand, and wisely manage credit.



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Credit Scoring

Credit scoring is designed to give lenders a fast, accurate prediction of the risk involved in giving you a loan. Scores range from 300 to 850, with the vast majority of people falling in the 600s and 700s. The higher the score, the more access to credit and better borrowing rate you will have.

FICO Score

The following five characteristics separate the cream of the crop from everyone else:

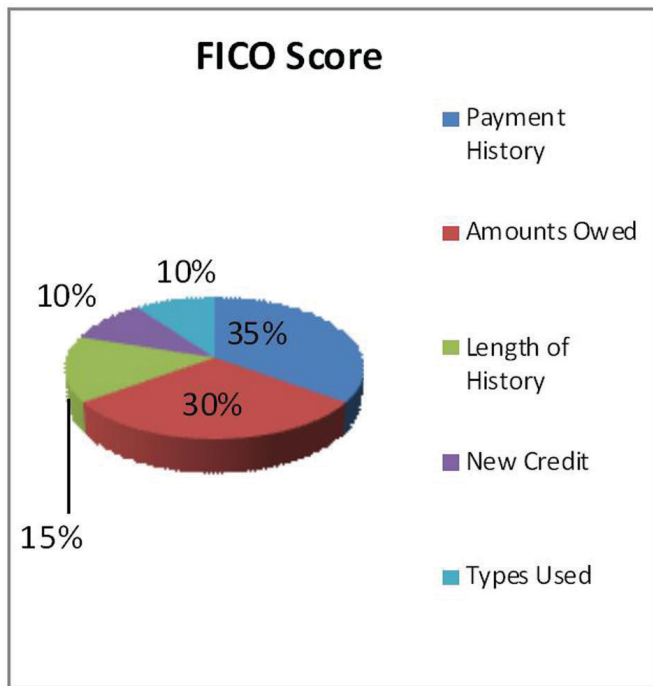
- **(35%) Payment History.** People who have failed to make payments in the past tend to do the same in the future.
- **(30%) Amounts Owed.** Someone who is maxing out or close to the limit on a credit card is considered a greater risk. Keep debt-to-limit ratio below 50%.
- **(15%) Length of Credit History.** Assumes people who have had credit for a long time are less risky.
- **(10%) New Credit.** The system frowns upon those who have initiated several requests for credit cards, loans, or other debt instruments over a short period.
- **(10%) Types of Credit Used.** Consumers are expected to have a few of each, but too much of either one can negatively affect your score.

On installment loans, such as a car payment, a person borrows money once and makes fixed payments until the balance is gone. With revolving credit, such as a credit card, borrowers' have a line of credit to use and make regular payments.

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- Overextended credit
- Paycheck garnishments
- Bankruptcy

Less-Than-Perfect Credit

The first step is to understand if you are considered a credit risk. Most lenders will consider you a higher credit risk if your credit report states that you have more late and slow payments than stated in the categories given below:

- **Revolving credit (credit cards):** You should have no payments 60 days or more past due and no more than two payments 30 days past due.
- **Installment credit (car loans):** You should have no payments 60 days or more past due and no more than one payment 30 days past due.
- **Housing debt (mortgages and rent):** You should have no payments past due.

Copies of canceled checks for the past 12 months or a loan payment history from the mortgage provider can prove payment history. If your credit report is less than perfect, you will need to consider the following:

- **All late payments** must be explained. Contrary to popular belief, good credit does not necessarily mean perfect credit. If your credit reports show any 60- to 90-day late payments, you may need to seek out a lender that specializes in less-than-perfect credit.
- **Know your credit limit**, which is based on your income, the amount of your current debt and your credit history. Your credit limit is the amount of credit you have available to you.
- **Creditors look** at how deeply you **COULD** go into debt when they review your record. If you have several cards you do not use that have high credit limits, potential lenders worry that you will go on a shopping spree and overextend yourself.
- **Pay against your balance** as soon as you can. It is important not to let your bills hang around. Late charges will be assessed, a negative rating will hit your credit file, and more interest charges will accrue.
- **If you are unable to make your payments** on time, or you want to dispute a charge, contact your card issuer immediately. Above all, get everything in writing.

Your Credit Score

You can use your credit score to improve your credit worthiness and negotiate for the best possible terms. The credit history is what you see when you get a copy of your credit report. If you know you have a low score because you have not established a credit history or you have a blemished credit record, you can take a few steps to build it up:

- Pay your bills on time.
- If you have missed payments, get current and stay current.
- Know how much you owe; keep balances low; and pay off debt rather than moving it around.
- The length of your credit history/age of account(s) matters—usually the older it is, the better because this offers lenders a clearer picture of your credit worthiness. Another option available to potential borrowers with low credit scores is to ask a lender to review your history of alternative routine payments such as rent and utilities that demonstrate your ability to pay. This is less commonly available today but some lenders may consider it.

RED FLAGS potential lenders look for in your credit report may include:

- Late payments
- Recent credit inquiries
- Underpaying
- Liens

Clean Up My Report

For severe financial problems, contact one of the personal credit counseling organizations, such as Money Management International at 1-866-310-7452 or online at <http://www.creditcounseling.org/>. Understand that a bad credit record will haunt you for years.

The general guidelines for cleaning up your credit report include:

- Contact credit agencies via <http://www.annualcreditreport.com> to get a copy of your report.
- Contact lenders to renegotiate payment plans.
- Pay bills on time.
- Limit the amount of outstanding debt.