

THE IMPORTANCE OF CREDIT SCORES

WHAT IS A CREDIT SCORE?

A credit score is a number that shows how likely you are to repay debts on time. The United States has set up this system to evaluate payment history much quicker and more equitably across individuals living and working in this country. The most commonly used credit scoring system is called FICO, created by the Fair Isaac Corporation.

WHY IS A CREDIT SCORE IMPORTANT?

Your credit score tells any individual evaluating you how trustworthy you are, someone they can tell pays their bills on time, is someone they are more likely to trust lending and offering services to.

Credit Cards: Good scores can get you credit cards with better rewards, higher limits, and lower interest rates.

Loans: Banks use credit scores to decide if they will give you a loan and what interest rate you will pay.

Other:

Renting: Landlords check credit scores to see if you will pay rent on time.

Car Insurance: Often companies use credit scores as a part to set your insurance premiums.

Obtaining your own cell phone plan: without credit often companies that provide a service before you pay for it may require you to provide a downpayment of cash if your credit doesn't show you're trustworthy or contain enough information to evaluate.

HOW TO BUILD CREDIT

Get a Credit Card:

Joint Credit Card: Share a card with someone who has good credit.

Secured Credit Card: Pay a deposit to get a card.

Starter Credit Card: Get a basic card from your financial institution.

Credit Builder Loan:

Some banks and credit unions offer loans that help you build credit by making regular payments

Make sure any credit you obtain you always pay the bill on time, every time

FIVE FACTORS TO YOUR CREDIT SCORE



Payment History – 35%

As you might expect, the repayment of past debt is a major factor in the calculation of credit scores. It helps determine future long-term payment behavior. Both revolving credit (i.e. credit cards) and installment loans (i.e. mortgage) are included in payment history calculations. Although installment loans take a bit more precedence over revolving credit. That's why one of the best ways to improve or maintain a good score is to make consistent, on-time payments.

Amounts Owed – 30%

This category is basically credit utilization or the percentage of available credit being used/borrowed. Credit score formulas “see” borrowers who constantly reach or exceed their credit limit as a potential risk. That is why it's a good idea to keep low credit card balances and not overextend your credit utilization ratio.

Length of Credit History – 15%

This factor is based on the length of time all credit accounts have been open. It also includes the timeframe since an account's most recent transaction. Newer credit users could have a more difficult time achieving a high score than those who have a credit history. Since those with a longer credit history have more data on which to base their payment history.

Credit Mix – 10%

FICO® Scores consider the combination of credit cards, retail accounts, installment loans, finance company accounts and mortgage loans. Credit mix is not a crucial factor in determining your FICO Score unless there's very little other information from which to base a score.

New Credit – 10%

Today's higher use of credit factors into FICO® Score calculations. Still, opening several new credit accounts in a short period of time can signify greater risk – especially for borrowers with a short credit history. So how one shops for credit and within what timeframe can affect a FICO Score in a number of ways.