Debt & Credit Scores

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Disclaimer: This is not financial advice.

What is a credit score?

A credit score is a three-digit number used by lenders to assess your creditworthiness. Credit scores let lenders and creditors know how much of a risk you pose as a borrower, indicating your ability to pay your bills on time. This number guides their lending decisions on credit limits, loan terms, and interest rates.

How do credit scores work?

Credit scoring models analyze credit reports from the three major credit monitoring agencies and assign a score to the consumer based on that data.

There are different credit scoring systems available, and each lender will favor one over the other. Some are for general use, while others are tailored to specific lending industries like mortgage and auto loans.

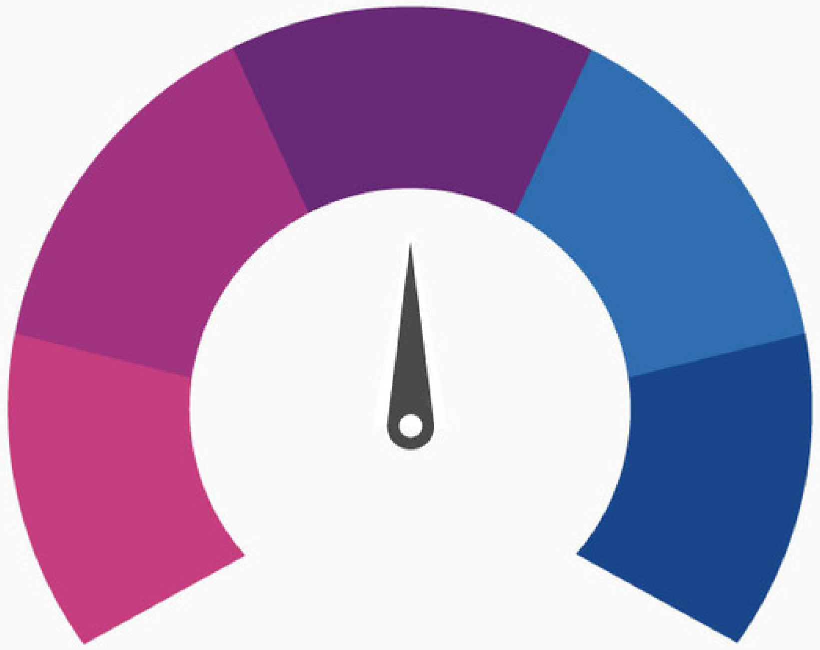
The most widely used are FICO (Fair Isaac Corporation) and VantageScore 3.0.

Credit Score Ranges

FICO Score

- Very Poor: **300-579**
- Fair: **580-669**
- Good: **670-739**
- Very Good: **740-799**
- Exceptional: **800-850**

Vantage Score



- Very Poor: **300-499**
- Poor: **500-600**
- Fair: **601-660**
- Good: **661-780**
- Excellent: **781-850**

Source: Experian

How are credit scores calculated?

Every score is based on information gathered by the major credit bureaus: Experian, Equifax, and TransUnion. These credit reporting agencies gather data from credit card companies, financial institutions, and lenders to create a report.

Credit scoring models analyze the credit report information and assign value to each factor. Depending on the model, some factors will be highly influential while others only account for a small percentage of your overall score. As a result, different scoring models will produce different credit scores, even if they reference the same credit report

Difference between credit scores and credit reports

Your credit score is not the same as your credit report. Credit scoring companies use the information on your credit report to determine your credit score.

A credit report documents your credit and payment history. It’s the information contained within your credit report that determines your creditworthiness and, consequently, your score.

How can I get my free credit report?

1. Online by visiting AnnualCreditReport.com.
2. By calling 1-877-322-8228 (TTY: 1-800-821-7232)
3. By filling out the Annual Credit Report request form and mailing it to: Annual Credit Report Request Service. PO Box 105281. Atlanta, GA 30348-5281.

Factors that determine Credit Scores

1. Payment History: 35%
2. Amounts Owed: 30%
3. Length of Credit History: 15%
4. Credit Mix: 10%
5. New Credit: 10%

Payment History

Making debt payments on time every month benefits your credit scores more than any other single factor—and just one payment made 30 days late can do significant harm to your scores. An account sent to collections, a foreclosure, or a bankruptcy can have even deeper, longer-lasting consequences. Payment history accounts for about 35% of your FICO® Score.

Amounts Owed

The total amount you've borrowed affects your credit score, as does the portion of your available credit tied up in outstanding balances. Your credit utilization ratio, or rate—the percentage of your total borrowing limit you're using on your credit cards and other revolving-credit accounts—is a significant factor in determining credit scores. It is also one of the factors that's most responsive to your actions. For instance, paying off a high-balance credit card one month can help you see a credit score boost once the payment is reported to the credit bureaus and a new score is calculated.

Length of Credit History

- The longer your credit history, the higher your credit score will tend to be.
- The FICO® Score evaluates your experience with credit by measuring the age of your oldest credit account, the age of your newest credit account, and the average age of all your accounts.
- Note that closing accounts and paying off loans in full caps the payment history for those accounts, but it doesn't immediately cancel out their ages for purposes of calculating the length of credit history.
- Accounts you choose to close in good standing (meaning with no late payments) remain on your credit report for as long as 10 years.
- The length of your credit history accounts for about 15% of your FICO® Score.

Credit Mix

The ability to successfully manage multiple debts and different credit types tends to benefit your credit scores. Credit scoring systems favor a mixture of installment debt (such as student loans, mortgages, car loans and personal loans) and revolving accounts (credit cards and lines of credit). Credit mix comprises about 10% of your FICO® Score.

New Credit

- Credit scoring systems may ding your score a small amount in response to hard inquiries—entries that appear on your credit report when a lender processes a credit application from you.
- Your credit will usually decrease by less than five points for an inquiry, and if you keep up with your bills, your score will typically rebound within a few months.
- Hard inquiries are not all treated the same, however.
- Credit scoring models lump together hard inquiries on the same type of loan such as mortgages, car loans, and student loans made within a short period of time (two weeks to be safe) and consider them as one inquiry.
- Note that hard inquiries made in relation to credit card applications don't get this same treatment: Each inquiry is considered separately and can have a bigger impact if you apply for several cards in a short time span.

What Constitutes a Good Credit Score?

- The most common credit score ranges from 300 to 850 points. VantageScores considers 660-700 a good score, while FICO's falls between 670 and 739.
- Scores above 800 are "excellent" or "exceptional" in both models – the highest tier possible.
- A higher credit score increases your chances of loan approval.
- This "creditworthiness" helps determine how much you can borrow when applying for a mortgage and other types of financing, like car loans, and personal loans.
- Credit scores also affect the credit limit on credit cards.
- If your credit score indicates you're well equipped to repay, lenders may offer you a lower interest rate, and you'll pay less for borrowing. Unfortunately, the opposite is also true.

Lower Credit Score = Higher Interest Rate

30-year fixed
$300,000 mortgage

Over the life of a mortgage, a low credit score can cost you tens of thousands of dollars in interest.

FICO Score	APR	Monthly Payment	Total Interest Paid
760-850	2.458%	$1,081	$114,011
700-759	2.68%	$1,112	$125,497
680-699	2.857%	$1,138	$134,792
660-679	3.071%	$1,170	$146,188
640-659	3.501%	$1,235	$169,610
620-639	4.047%	$1,320	$200,328

Source: myFICO

What Can Lower Your Credit Score?

- Bankruptcy
- Foreclosure
- High credit utilization
- Late payments
- Credit inquiries

Bankruptcy

A healthy credit score can go down hundreds of points after filing for bankruptcy, and the bankruptcy note stays on the report for up to 10 years.

Foreclosure

If you are delinquent on your mortgage payments, the lender can foreclose the mortgage by taking ownership of the property. Therefore, this negative mark bears a lot of weight and stays on the report for 7 years.

High Credit Utilization

Having one or more credit cards in good standing can help your credit score, but if you’re using more than 30% of your revolving lines of credit, it will depress your score. A smart move is to roll over balances between cards to get the overall utilization below the 30% threshold.

Late Payments

Late payments tell lenders that you pose a risk they may not be comfortable with. Just one late payment can remain on your credit report for seven years.

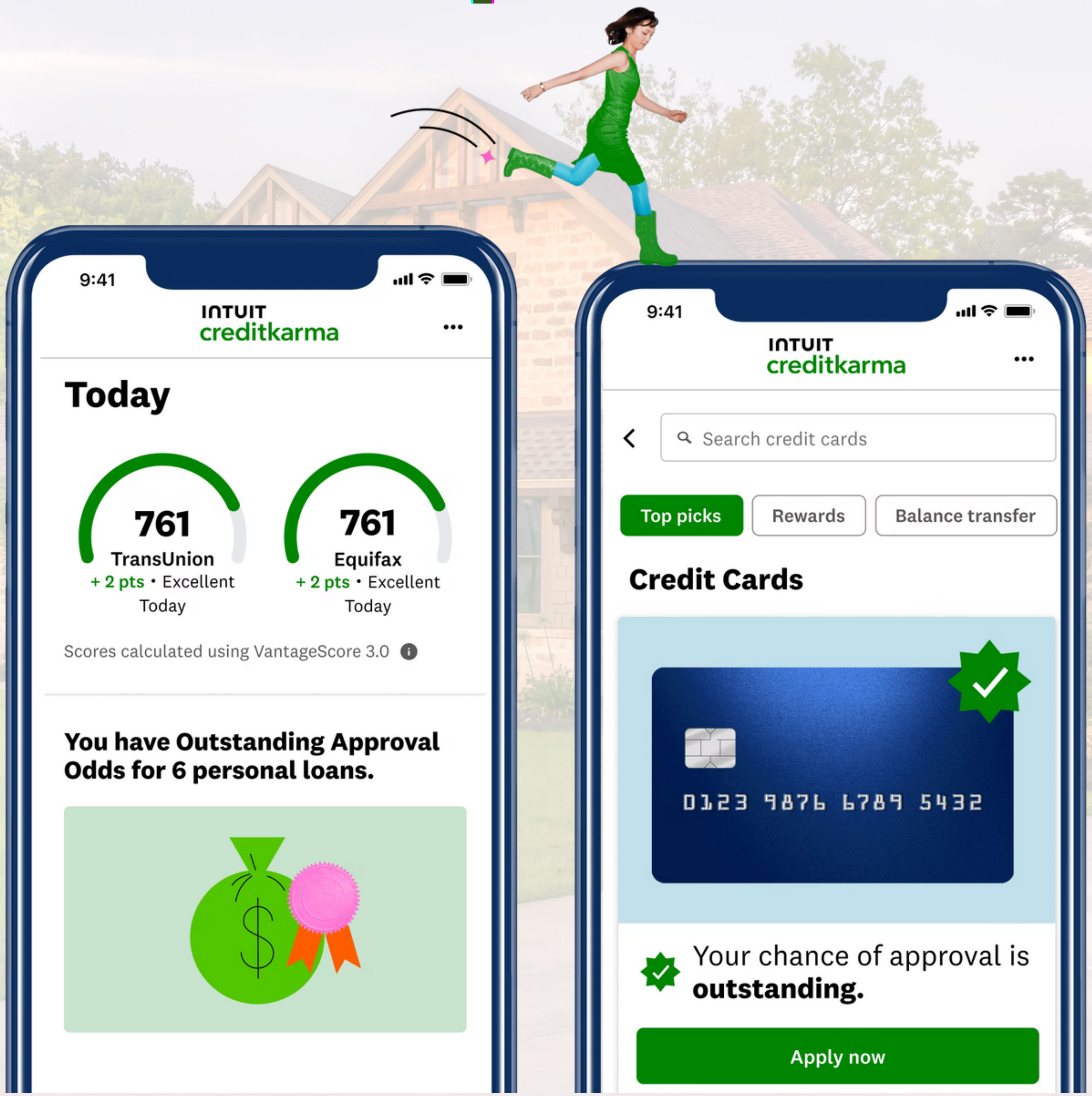
Credit Inquiries

Hard inquiry	Soft inquiry
Tied to a formal loan or credit application	No formal loan or credit application linked to the inquiry
Lenders use it to accept or reject your application	Lenders and credit card issuers employ it to pre-approve candidates
Must be authorized	Prospective employers and even phone companies do soft checks as part of your evaluation
Remain on your report for up to two years	Looking at your own credit report counts as a soft inquiry
Too many can lower your overall score	Are only visible to you and don't impact your score

Credit Counseling

For personalized advice to improve your overall financial situation, look to credit counseling. Non-profit organizations such as the National Foundation for Credit Counseling (NFCC) can help you better understand your credit and improve your score over time.

Tip #1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TransUnion
+ 2 pts • Excellent
Today
761
Equifax
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Today
Scores calculated using VantageScore 3.0
You have Outstanding Approval Odds for 6 personal loans.
9:41
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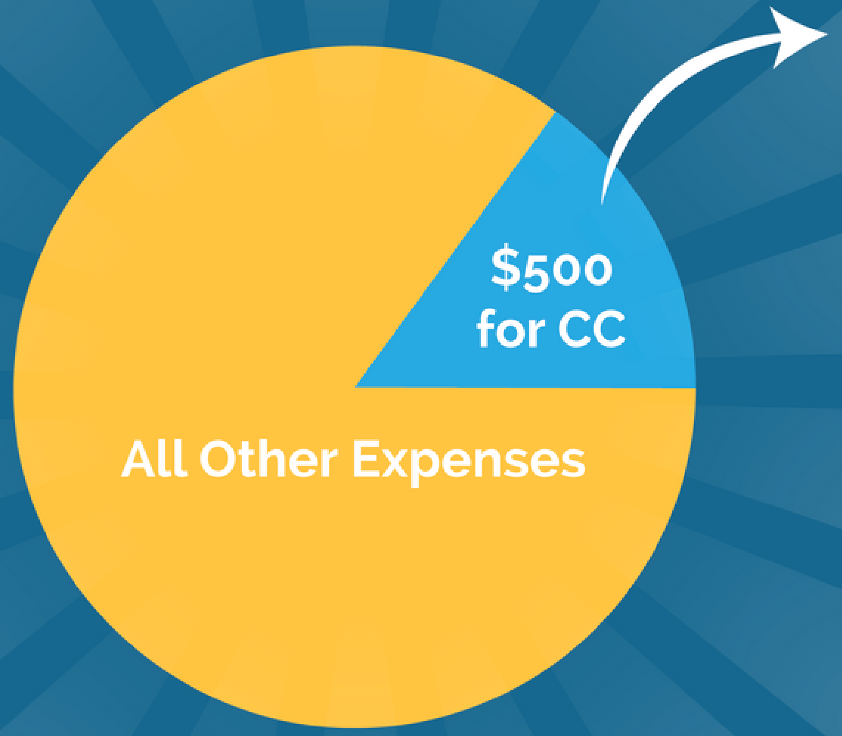
Top picks
Rewards
Balance transfer
Credit Cards
0123 9876 6789 5432
Your chance of approval is outstanding.
Apply now

Tip #2

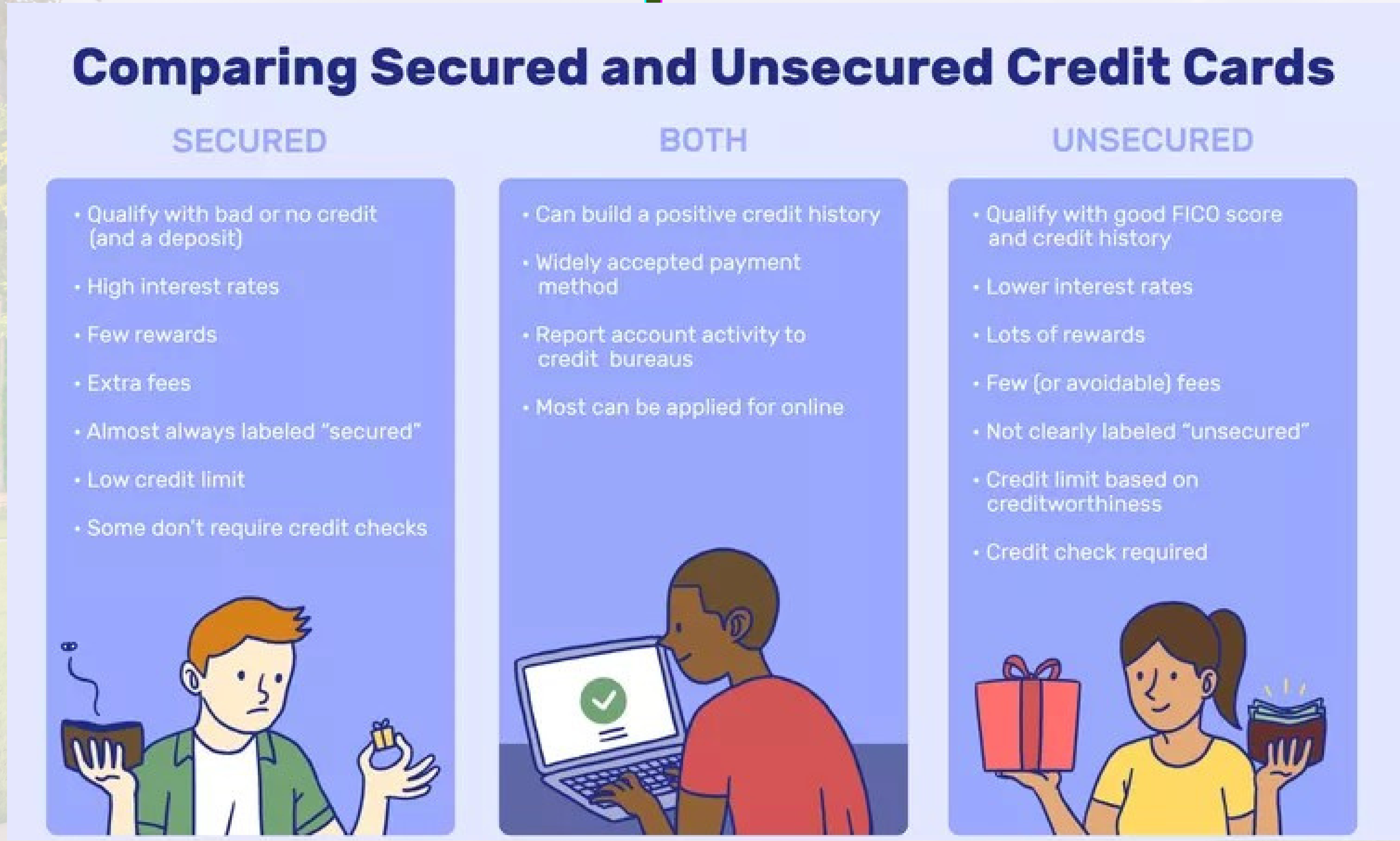
Debt Snowball Method



$500 Total for Credit Card Repayment			
Name	Balance	Min.	New Payment
CC1	$1000	$20	$20 + $260 = $280
CC2	$3000	$60	$60 + $280 = $340
CC3	$8000	$160	$160 + $340 = $500

Make the largest payment possible on your smallest debt, while paying the minimum payments on the rest. Once this debt is repaid, apply its payment to the next smallest debt. Repeat until all debts are repaid.

Tip #3


Comparing Secured and Unsecured Credit Cards
SECURED
BOTH
UNSECURED
• Qualify with bad or no credit (and a deposit)
• High interest rates
• Few rewards
• Extra fees
• Almost always labeled "secured"
• Low credit limit
• Some don't require credit checks
• Can build a positive credit history
• Widely accepted payment method
• Report account activity to credit bureaus
• Most can be applied for online
• Qualify with good FICO score and credit history
• Lower interest rates
• Lots of rewards
• Few (or avoidable) fees
• Not clearly labeled "unsecured"
• Credit limit based on creditworthiness
• Credit check required

Tip #4

NEVER SHARE YOUR SOCIAL SECURITY NUMBER

Summary

A credit score measures your creditworthiness and guides the creditor's lending decisions on loan rates, terms, and loan amounts. Credit scoring companies use data from your credit report — a detailed record of your borrowing history and behaviors — to calculate your credit score. A healthy credit score is founded on good borrowing practices: on-time payments, moderate debt amount, and low credit utilization.

You need a good credit score to qualify for better loan terms and interest rates. A poor credit score does not prohibit you from borrowing money, but it's a big obstacle for mortgage or car loan applications. Low credit limits your lender options, raises your interest rates, and can even disqualify your loan application.

"We don't have to be smarter than the rest. We have to be more disciplined than the rest."

-Warren Buffett

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