

The Good \$teward

Improving Your Credit Health

I am sure that by now you have heard all of the news about credit scoring. Credit scoring has been around for a long time. It was once this top secret number only known by potential creditors, banks, and a company out of San Rafael, California by the name of Fair, Isaac & Company. The credit score is known in the lending industry as FICO (from the name of the company that calculates the majority of the scores out there). For years, we have been focused on debt reduction solely. However, you can reduce your debt and not impact your credit score significantly.

WHAT IS YOUR CREDIT SCORE?

A credit score is a three digit number which shows how likely an individual is to pay a loan back and to pay it back on time. In essence, your credit score is an indication of your credit health. Quite naturally, the lower your score the greater risk you represent.

WHY SHOULD I CARE?

For two major reasons: first, it is used to determine your loan worthiness and the interest rate you will pay and second, it can be improved without paying off all your debt. The majority (more than 75%) of loans are determined by your FICO. For instance, let's say that you have a credit score that is 560-619 and you are interested in obtaining a 30-year fixed rate mortgage to purchase a \$75,000 home in the state of Pennsylvania. You would most likely be given an interest rate of 8.72% and pay more than \$135,000 in interest over the lifetime of the loan with a monthly payment of approximately \$589. You might say, "Hey, that's much less than I am currently paying in rent for my apartment. So, what is the problem?" Well, look at the chart below which shows what would happen if you improved your credit score. Are you shocked? I was.

FICO Score	APR	Monthly Payment	Total Interest Paid
720-850	5.592%	\$430	\$79,865
700-719	5.717%	\$436	\$81,999
675-699	6.252%	\$462	\$91,279
620-674	7.396%	\$519	\$111,869
560-619	8.723%	\$589	\$136,889
500-559	9.389%	\$625	\$149,847

Note: The information which appears in this chart is for illustration purposes only and was obtained from <http://www.myfico.com/myfico/CreditCentral/LoanRates.asp>

Raising your credit score to 675-699 would lower your monthly payment 21.6% and save you \$45,610 over the life of your loan. Again, I hear you thinking, “There is no way I am going to be able to raise my score that much.” It may take some time but even a slight improvement may have benefits. Raising your score to the next range will save you \$25,020 in interest over the life of your loan.

HOW IS MY SCORE DETERMINED?

There are five primary things that go into your score according to Fair Isaac. In general, the approximate impact of each of these items on your score is listed below. However, the impact of any one individual item depends on your individual circumstances.

1. Payment History (35%)
2. Outstanding Debt (30%)
3. Credit History Length (15%)
4. Amount of new credit (10%)
5. Type of credit (10%)

The great thing about your credit score is that you are not always penalized for past credit problems. FICO weighs your recent credit history more heavily than your past credit history. As you begin to make payments on time and reduce your debt, the impact of your negative credit is diminished.

HOW DO I IMPROVE MY SCORE?

The two greatest impacts on your credit score are your payment history and your outstanding debt. So, you want to have a two-pronged approach: pay your bills on time and reduce your debt load. Something as simple as starting to pay your bills on time can have a significant impact on your credit score if in the past you were plagued with late payments.

Remember, all credit information stays on your credit report for seven years. As a result, closing accounts or paying off accounts in full is not always recommended. Don't forget that your credit score is affected most by your payment history and your outstanding debt. So, at times it is better to bring an account current and make regular timely payments for a period of 6-12 months rather than to pay the full balance on a delinquent account. Why this recommendation? Typically, your credit score is impacted by the last 6 – 12 months of payment history. If you close an account by paying the full balance and the last 5-11 payments were late then this will potentially have a negative impact on your credit score.

Also, reduce your application for new credit and make sure you have a healthy balance of credit type. However, before you can do any of the things listed above you must first know what your score is. Obtain a copy of your credit score and report from each of the three agencies. Don't be surprised if each agency reports a different score. Get in the habit of obtaining your credit score and report at least once a year and before making a major purchase. Don't be discouraged if you do not see drastic changes in your credit score. While negative events such as bankruptcy have an immediate impact on your score, improvements may not happen for 6-12 months. As a result, you should check your report at least twice a year if you are actively working towards increasing your score. ✨

Where to find additional information about credit scoring:

Fair, Isaacs and Company has a website where you can find extensive information about credit scoring, www.myfico.com .

Credit reporting agencies:

Equifax: www.equifax.com or 800-685-1111

Experian (Formerly TRW): www.experian.com or 888-397-3742

TransUnion: www.transunion.com or 800-888-4213