FAMILY FINANCIAL EDUCATION FOUNDATION

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The 411 On Credit Repair

If you are over the age of 18 and are out of your parent's home, likely you have run into the term "credit score." Whether applying for a credit card or trying to buy a vehicle, you quickly realize how crucial a high credit score becomes in getting the best financial terms, the most profitable opportunities and in actuality to the entire health of your financial life.

In fact, your credit score affects things beyond credit purchases. For example, are you trying to rent a place? The first step for any reputable landlord is to pull a credit check. Think your automobile insurance is too high? Often, people do not realize that auto insurance rates are heavily tied to your credit score.

With access to the best financial terms, lower payments and low-interest rates, it is simply common sense that a good credit score can save you thousands of dollars every year. It is no wonder then that so many people are looking for ways to repair less than great credit. Before you can repair it, however, you need to understand it.

What exactly is a credit score?

Essentially, your credit score is a three-digit number that fluctuates from around 300 to 850, but that range can change depending on which scoring model is used. The higher credit score you have, the more creditworthy lenders view you. There are cases in which you can have no credit score at all, and typically this happens to young adults that have just started to become independent and have never purchased anything in their name. In fact, this is one of the biggest challenges that young adults face when trying to set out on their own. However, this problem does not solely affect young adults; it can also affect those that have purchased primarily with cash and have never had a credit account or a loan. Later, we will discuss how to repair less than stellar credit and how to establish credit if you have none.

Would it surprise you to learn that you have more than one credit score? In fact, at a minimum you have three, thanks to the three major credit bureaus; Experian, Transunion, and Equifax.

These competitive credit bureaus collect and update your financial and credit history in a credit report, and then run calculations through a scoring model to provide a credit score. These bureaus are where your lenders (and others) go to view your credit and make a decision on your creditworthiness. They may seek your credit score from one, two or all three, depending on their preference.

Your score may vary widely between credit bureaus because the same information is not always recorded to all of the bureaus, or they may record or store the information differently.

Different credit bureaus are not the only reason you have more than one credit score. In fact, you have far more than three credit scores because your credit score changes based on the scoring model used to perform the statistical analysis of your credit data.

This statistical analysis will put different weights on particular credit factors (such as debt type), with some factors affecting your credit more than others.

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The most widely used scoring model for lenders and the one you are likely familiar with is FICO, short for Fair Isaac Corporation. The Fair Isaac Corporation was the first company to offer a credit-risk model with a score.

There is not just one version of FICO, but many; with a different version used for mortgages, auto loans, credit cards and more. Additionally, FICO is not the only model used, and in fact, there are hundreds of scoring models, including FICO's biggest competitor, Vantage Score.

Although there are too many scoring models to name here, it is important to remember that every scoring model out there is used for a particular purpose, and its calculations are created according to that purpose. With hundreds of different scoring models out there you could have hundreds of different credit scores!

So, now that you know how it works, what exactly is on your credit report? And how do you assure it is accurate? Well, thanks to the Fair Credit Reporting Act, 15 U.S.C. § 1681 ("FCRA"), a U.S. Federal Government legislation enacted to promote the accuracy, fairness, and privacy of consumer information contained in the files of consumer reporting agencies, you as the consumer have certain rights and protections; including being entitled to a free credit report from each agency every 12 months.

On your credit report, you will find all of your financial accounts and their details including account balances, credit limits, loan amounts and payment history. This entitlement is great news for you, as there is no better way to know what is on your credit report, and in turn, what your lenders see than to get one yourself. You can obtain this free credit report by going to each bureau's website.

What happens if you find an error or you contest the information on your credit report? As luck would have it, the FCRA protects consumers under these circumstances by granting them the ability to dispute inaccurate items on your credit report.

Disputing an item on your credit report can be done by writing a dispute letter to each bureau and in some cases (if the Bureau website allows) a dispute can be submitted through their website.

FFEF can pull all three credit reports for you and a Certified Credit Report Reviewer at FFEF will go through it line by line with you to ensure the accuracy

What Gives Me a Bad Score?

To understand your credit score you need to get a better understanding of the factors that affect your credit rating. This knowledge can help you to avoid situations where your credit might be negatively affected.

- Short or non-existant credit history
- Late payments or not paying at all
- Defaulting on a loan
- Too many credit card or loan accounts opened in the last year
- Applying for too many credit or loan accounts in a short period of time
- Balances on credit cards that are at or near the maximum
- No recent credit card balances
- Too few or too many credit card accounts
- Closing credit cards that still have balances
- Closing old credit card accounts
- Not enough diversity between credit cards and loans
- Having a credit account charged off because of non-payment
- Public records show you have tax liens, judgments, or bankruptcies
- Having your home foreclosed because of late mortgage payments

TIP: Be cautious of websites that claim to offer free credit reports. A number of these sites will only give you a free report if you buy other products or services. Other sites give you a free report and then bill you for services you have to cancel. To get the free credit report authorized by law, go to www.AnnualCreditReport.com or call (877) 322-8228.

of the report. The counselors will guide you on how to submit disputes on any contested content.

Naturally, when taking into account the various credit data that is stored across three different credit bureaus, on top of the vast array of scoring models that may be used, it would be impossible to explain to you every variable that goes into a credit score.

Fortunately, scoring models have enough credit factors in common that addressing these factors will universally help raise your credit score. So just what are the most important credit factors to consider when trying to repair your credit?

Critical Credit Factors

In this section, we will discuss the credit factors that universally help your credit, regardless of which credit bureau or scoring model is used. However, for simplicity sake and because 90% of lenders use FICO (it is the most common scoring model), we will be using FICO as the example when stating percentages (or weight) of a credit factor.

Although different scoring models apply different percentages or weights to each factor, improving them will help raise your credit score across the board.

Payment History: This is the most valuable information the lender is after, and because your payment history covers 35% of your total score, it should be the factor you are most concerned with protecting. In fact, according to FICO a single 30-day late payment can drop a good score by 90 to 110 points. So it is no secret that paying on time every time is the best strategy.

However, nobody is perfect, and sometimes financial crisis happens. The good news is a single late payment won't hurt your credit forever, and the sooner you rectify it and the more time that passes between the delinquency and your current history, the sooner your credit will bounce back. Also, your misfortune will not haunt you forever.

There is a seven-year statute of limitations that regulates how long the late payment can be reported and the seven years starts from the date of the delinquency. If a late payment is showing up after seven years, you can dispute it and get it removed from your report.

You should see your credit score begin to rise once you start making all of your payments on time and dispute any old or inaccurate information that may appear on your credit report.

Debt Ratio: Coming in at 30% of your credit score, this factor holds only slightly less weight than your payment history. Sometimes called credit card utilization or amount owed, it is simply a matter of how much of your available credit is being used.

Your credit utilization ratio can be determined easily by adding your total outstanding balances and dividing it by your total credit limits to create a percentage.

Lenders like to see a ratio of less than 35% utilization and preferably closer to 10% for obvious reasons. A creditor is simply more reluctant to accept your application if they discover that you are overextended and relying too heavily on borrowed money. Paying off a large portion of your debt and bringing your utilization to a more desirable ratio can increase your credit score quickly.

Length Of Credit History: At 15% of your score this factor has a medium impact and is also the factor you have the least control over. It is also the credit score element that gives seasoned account holders an advantage over new account holders (provided your accounts are in good standing).

Your length of credit history is calculated differently between scoring models with some models using the age of your oldest account while others use the average age of your open accounts. It is an age-old scenario, much to the chagrin of new credit users, that after closing an unused credit card account, your credit score drops significantly because it then shortens the length of credit history.

If repairing your credit is the concern, it is far better to keep old accounts open and in good standing than to close them.

Your credit score is a three-digit number that fluctuates from around 300 to 850, but that range can change depending on which scoring model is used. The higher credit score you have, the more creditworthy lenders view you.

Your Credit Account Mix: While not a significant portion of your credit score at 10%, your account diversity is still important, because after all, when raising your credit score, every bit helps. Seeing a good mix of credit types is important to lenders because they like to see that you can manage a variety of accounts successfully. So what types of accounts are we talking about? While there are certainly more than two account types, the two leading contenders are:

1. Revolving accounts: A revolving line of credit is an account that does not have a fixed number of payments (but may have a required minimum) and the outstanding balance does not have to be paid in full every month and can in rolled over into the next month. Examples of revolving credit are credit cards, gas cards, home equity lines of credit and department store cards. Revolving accounts help prove that you can manage debt responsibly.

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2. Installment accounts: An installment account is an account that is paid back over a set period, and that has fixed amount that you pay every month. Things like mortgages, auto loans or student loans are considered installment credit and show lenders that you can successfully maintain a payment over time.

Becoming familiar with each type of credit account, you can easily see why if your credit is made up of only one type of account, it gives only part of the picture of your account management habits. Diversity in your accounts gives creditors a full picture of your financial management and also helps keep your score high.

It may be a good idea to open an account to round out your financial profile but beware of going into more debt if you cannot afford it. Opening up another account should only be done if you have a legitimate need for it and more importantly the ability to pay for it.

An additional credit factor sometimes correlated to the type of credit accounts you have are the number of accounts you have. Whether open or closed accounts, creditors often like to see more than a one or two accounts on your credit profile when considering you for a loan.

New Credit and Credit Inquiries: Opening a new account or applying for new credit will not automatically lower your score or disqualify you from a loan. However, having many new accounts (especially if you have only managed credit for a short time), warns creditors that you may not know how to handle your debt responsibly and it throws up a red flag. Having many new accounts may also temporarily lower your credit score.

At 10% of your new score, it is important to open new accounts responsibly along with an appropriate budget and well thought out financial plan. Additionally, applying for credit too often can also lower your credit score through what is known as "hard credit inquiries." A hard credit inquiry is when a lender or financial institution pulls your credit report to make a lending decision.

Too many of these credit checks will affect your credit score. It is important to note that the same is not true when a soft credit check is performed. An example of a soft credit check is when a person or company checks credit for a background check or getting preapproval for credit offers.

These soft inquiries can occur without your approval, but do not affect your credit score.

Additional Factors:

Other delinquencies that will negatively affect your credit are debts such as judgments, bankruptcy, and unpaid fines or taxes.

So now that you know how to raise and protect your credit score, what should you do if you don't have any?

Ways to establish a credit history:

The quickest and safest way to begin building your credit score is with a secured credit card. People with bad or no credit can easily get a secured credit card because before you can use it, you must put money into it. So, if you put $800 in the credit card account, then $800 becomes your credit limit.

Using a secured credit card will help you create a positive credit history, and although unsecured credit cards may have better rewards and no money to put down, your credit score does not view a secured or unsecured credit card any differently.

Another way to establish a good credit history is with a credit builder loan. A credit builder loan is a small loan, offered by credit unions and banks that help people with no credit or bad credit establish a positive credit history.

There is little risk to the lender because they deposit the money into an account and do not release the money to the borrower until the payments have been made in full. The loan can be for as little as $100, and as long as you have made your payments on time, it can substantially raise your credit score.

In conclusion:

Keeping a healthy credit score is important, and here at FFEF, we understand that it can often be an overwhelming task. That is why we have created personalized debt elimination and credit repair plans made to fit your particular situation.

If you need help to improve your credit, please don't hesitate to call us at (877) 789-4172. No matter what road you take, remember, there is simply no other financial tool that can open or close doors of economic opportunity like your credit score. Monitoring your credit report and making well-informed and responsible decisions will go a long way in protecting your most valuable financial asset.

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If you know of someone who would benefit from this information, please pass this newsletter along.

For more information about our services or how we can help you with your debt management program, please contact Family Financial Education Foundation at www.ffef.org.