Credit Score Basics

Factors used to make up a FICO credit score[1]:

There are hundreds of different credit scores used by lenders, insurers, and others. FICO 8.0 is the most common credit score model used by creditors, followed by the VantageScore.

1) **35% - Payment History:** This is the single most important factor in a credit score. The longer you paid your bills on time, the better the score. Payment history includes:

    - Payment information on each type of account (mortgages, installment loans, credit cards, etc.). Active positive information can remain on your credit report indefinitely, while a closed account with positive information usually stays on your report for 10 years from the date of closing.
    - Late loan or credit payments and collection accounts stay on reports for 7 years from the first late payment.
    - The credit score reflects when the late payment occurred, how many payments were late, and length of time of delinquency.
    - Public Records on your credit report:
        - Chapter 7 Bankruptcy – 10 years from date of filing
        - Chapter 13 Bankruptcy – 7 years from date of filing

↑ Score:

- Pay all bills on time.
    - Pay attention to due dates and due times.
    - Recent missed payments lower your score more than older missed payments from several years earlier.
- If you carry a credit card balance, pay more than the minimum every month. Paying only the minimum can lower your score.
- Schedule automatic monthly payments if that helps you pay on time.

[1] Source: Fair Isaac Corporation, www.myfico.com, retrieved 2018.

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2) **30% - Amount Owed:** This is the second most important factor of your credit score:

- Balances on accounts: Even if you pay off your credit card monthly, you balance is reported to the credit bureau based on the date/time the record is pulled. The creditor may not know if you pay off the balance in full.
- The amounts owed on different types of accounts are scored differently. For example, a mortgage is scored differently than a credit card or store loan.
- Your Credit Utilization Ratio (CRU) is how much you've borrowed on revolving credit compared to the total amount of credit available to you. The closer a credit card is to the credit limit, the lower the score.
- Installment loan balances, like a car loan, are compared to the original loan amounts. As the loan balance goes down, it shows you're able and willing to manage and repay debt.

🡅 Score:

- Pay off credit cards in full every month to keep the balance from growing.
- Use less than **25%** of your credit limit on credit cards, even if you pay it off every month. For example, if your credit card limit is $1000, do not charge more than $250. To raise your score, use no more than **5%** of your credit limit.
- Pay attention to credit card limits – card companies can lower your credit limit which can trigger over-the-limit fees.
- Keep current credit card accounts open and use them every few months.

3) **15% - Length of Credit History:** In general, the longer your credit history, the better your credit score. Length of credit history factors include:

- How long credit accounts have been open. To have a credit score, your credit report must list at least one account that's been open for six months or more.
- The age of the oldest account, the age of the newest account, and the average age of all your accounts combined.
- How long it has been since you used your credit accounts.

🡅 Score:

- If you're young or don't have a very long credit history, don't open a lot of new accounts too quickly. That can lower your average account age and your credit score.
- If you pay off a credit card, don't close the account if it is an account you have had for a while. If you only recently opened it, closing the account may not have much effect.
- Ask a family member with good credit if you could be an authorized user on their credit card – that's **IF** their creditor reports authorized user data to the credit bureaus. You could also ask to be added as a joint account holder. NOTE: there are risks with attaching your credit report to another person.
- Secured credit cards can help build up a credit history but **only** if the creditor reports to a Credit Reporting Bureau.

4) **10% - New Credit:** Red flags go up when many accounts are opened in a short amount of time. New accounts show up a "hard inquiries" in a credit report. New credit factors include:

- Multiple credit requests/inquiries lower your score, with a few exceptions:
  - Inquiries that were made within the prior 30 days don't count towards your score.
  - Inquiries older than 30 days that occur within a "typical shopping period" for the same type of transaction (home loans, car loans) will only count as one inquiry. 'Typical' could range from 14-45 days depending on the credit scoring model.
- How long since a new account was opened and the type of account that was opened.

> **🡅 Score:**
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> - Comparison shop for a home or car loan within a 14- to 30-day period.
> - Think twice about store offers to open a new credit card to receive an instant discount on your purchase. The new account could lower your credit score and cost you more in interest and insurance rates than you will have saved with a 10% discount on your purchase. Plus, you should take time to review the details of the offer – hard to do in the checkout line.
> - When you apply for new credit, a "*hard inquiry*" shows up on your credit report and can lower your credit score for many months. Too many hard inquiries can send the message to creditors that you are desperate for new credit. ("*Soft inquiries*" don't affect your score so don't worry about ordering your free annual credit report and/or requesting a free report if you've been turned down for credit.)

5) **10% - Types of Credit Used:** The types of credit include the following factors:

- The mix of accounts including mortgage loans, credit cards, installment loans, finance company accounts, etc.
- This is usually not a major factor in the credit score unless the credit report does not have a lot of other information to base the score.

> **🡅 Score:**
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> - It's good to have at least one major credit card in addition to a few retail store credit cards. Experts say 3 active installment and revolving accounts are ideal, but 5 credit cards can lower your score.
> - Don't open new accounts just to have a better credit mix. That could lower your score more in the short term.
> - "Payday" and title loans may not report to Credit Reporting Bureaus unless you miss a payment. Even if the lenders do report regular payments to the Bureaus – be careful using these higher cost forms of credit since other lenders may view them negatively.

Source: Credit Score Basics, University of Wisconsin-Extension, 2018.

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