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Credit scores made simple

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These days, it's not just your lenders that care what your credit score is.

Insurance companies look at it, as do landlords and even employers to screen candidates, says Glinda Bridgforth, author of "Girl, Get Your Credit Straight!"

Typically, having a low credit score means you're considered a high credit risk to lenders. As a risky borrower, you might face more fees, higher interest rates and even get turned down for jobs and loans.

Of course, businesses will consider other factors besides your credit score when deciding whether to approve you and at what rate -- they might factor in length of employment, income, the number of years lived at your current residence and the amount of debt you have, says Bridgforth.

Still, lenders heavily rely on your score to determine your creditworthiness. Asked whether credit scores are more important than credit reports to lenders, John Ulzheimer, president of consumer education for Credit.com, says that the credit score has rendered the credit report useless, since it largely automates the tedious process of analyzing credit reports.

Factors that make up your score

That doesn't mean your credit report isn't important. Your credit risk score is based on your credit report. Certain sections of it get considered in the calculation of a credit score.

Your identifying information won't count toward your score and neither will your consumer statement, if you have one. Soft inquiries created when you requested your own credit report or existing creditors pulled your file for an account review don't count either.

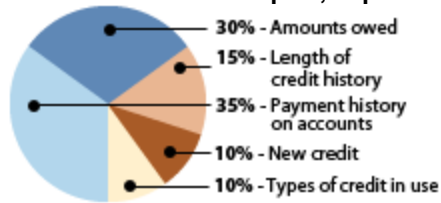
The sections that do matter to your score include public records -- judgments, liens and bankruptcies -- third-party collections, hard inquiries and your account history. The account history is the meat of your score, says Ulzheimer. It's where many aspects of your accounts will be considered (link to account history section "How credit reports work") .

Numerous scoring models exist, but the one used by most lenders is the FICO or FICO Classic score, created by Fair Isaac Corp. FICO scores range from 300 to 850, with higher numbers being better than lower scores. The median FICO score in the United States is a 723. For the purposes of this article, we will focus on the factors of your credit history that affect your FICO score.

Check out this chart to see exactly what comprises a FICO credit score and how to improve each factor.

Once you get your credit report, you'll notice that the information contained in it is organized in sections: your personal information, credit summary, account information, inquiries, collections and public records, along with summaries of your rights under state law and the Fair Credit Reporting Act, plus instructions on how to dispute information found in your report.

Sections of a credit report, explained



- [Payment history on accounts](#)
- [Amounts owed](#)
- [Length of credit history](#)
- [New credit](#)
- [Types of credit in use](#)

1. **Payment history on account (35 percent)**

Paying your bills on time is the most important thing you can do for your FICO score. Mind the due date, and make sure your payments have made it to the lender by then. Allow for seven to 10 business days for your payments to arrive, or if you're paying online, adequate processing time.

FICO score pie chart used with permission from Fair Isaac Corp.

2. **Amounts owed (30 percent)**

The second biggest factor, amounts owed, translates to how close to the credit limits you are on your cards. "If you're trying to max out your score, you want to charge less than 10 percent of the card's limit," says Ulzheimer, adding that he's frustrated that 50 percent is sometimes advised because nothing "magical" happens with your credit score if you're charging 50 percent of your credit limit. "At least realize that a higher percentage won't win you as many points," he says.

3. **Length of your credit history (15 percent)**

The third factor is the length of your credit history. Only time can help you there, but one mistake people can avoid here involves closing old credit cards. Closing an old credit card shortens the length of your credit history and lowers the total credit you have available from all your accounts. With a lower total credit limit, you end up looking more maxed out than you really are. You actually benefit from the unused card, he says, because it helps your utilization ratio -- how much you owe compared to your available credit.

But suppose you have an old, unused retail card that has a high interest rate. Ulzheimer, who formerly worked for Fair Isaac, says that first off interest rates are not factored into the FICO score. To keep the card open, he advises using it periodically to buy small items and then pay off the balance. The benefit of keeping unused cards comes when you do need to charge a large balance. Because your credit limits are so high, the large balance will affect your credit score less. There is a component for having too many credit cards, he says, but it's worth fewer points than charging too much on fewer cards.

4. **New credit (10 percent)**

The fourth category, new credit, refers to applications you've put in recently for new credit. It includes recent inquiries, how many recently opened accounts you have, how old each account is and how old each inquiry is. Every time you apply for in-store credit, for example, you're giving permission to pull your credit report and that counts against your score. Not every inquiry will count against your score, however. According to myFICO.com, the FICO scoring model ignores mortgage and auto inquiries generated in the 30 days before scoring and counts older mortgage and auto inquiries made within a short period of time -- a 14- or 45-day window, depending on the version of the FICO scoring model -- as one inquiry.

5. **Types of credit in use (10 percent)**

The fifth category looks at the different types of credit you have. You'll likely have a better score with a mix of revolving credit, and installment credit, such as mortgages and car loans. That said, don't take on more debt than you can handle simply to improve your score. Paying your bills on time earns you more points than having a pleasant potpourri of credit accounts.

When to buy your credit score

Check your credit score six months in advance of applying for a large loan, says Craig Watts, the public affairs manager for Fair Isaac Corp. That way, you have time to make changes that could improve your score, such as paying down large account balances.

"For general maintenance purposes, it's a good idea to check your score at least once a year because if your score changes significantly, it's an indication that something is not right," he adds.

Checking your FICO score a few days in advance before applying will give you a number that should be close to what the lender will get, but if the lender gets a slightly different number, don't be overly alarmed. Ulzheimer says the lender could be using a score based on a different credit report. They could be using a different version of the FICO score or even an industry-specific FICO score, called an industry option score. "It's still going to be close," he says.

Scores improve gradually

"It's important to be patient with the process when it comes to increasing your credit score," says Bridgforth. "Once you've fixed all errors, are paying your bills on time, reducing balances by paying more than the minimum payments and lowering interest rates as much as possible, be patient and let time work to your benefit. I know it can feel like you're watching grass grow, but if you're consistent with following these healthy habits, your credit score will definitely increase and you'll be well on your way to getting your credit straight."