Funding Your Future

Brought to you by: South Wood County Financial Stability Coalition — A United Way of South Wood & Adams Counties Coalition

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Understanding Your Credit Score

Many people use the terms “credit report” and “credit score” interchangeably, but they are not the same. Your credit report is a detailed account of your credit history. Your credit score is a three-digit number representing your credit-worthiness. A credit score is simply a way for lenders to quickly determine if you’re a reliable borrower, and to what degree.

Since lenders use your credit score as a determining factor in major financial situations like purchasing a home or vehicle, it is important to know how it affects you and how to improve it, if necessary. Unlike credit reports, you generally have to pay to view your credit score. However, your credit score is calculated using the information in your credit report, so you can get a general idea of your score if you review your report regularly. Although free educational credit scores and credit score calculators are available, the FICO score is most commonly used in the United States, and does require purchasing.

Contrary to popular belief, we each have *several* credit scores. Different companies calculate credit scores in different ways. Regardless of how its calculated, your score will always consist of five main components: payment history, amount of current debt, length of credit history, amount of new credit, and types of credit. Companies use these factors to calculate a score ranging from a low around 300 to a high around 900.

Your credit score is important because financial institutions use it to decide whether to offer you a loan or credit, how much you may borrow (credit limit), the period of time you have to repay, and the interest rate (how much it will cost). In general, many lenders find FICO scores above 670 as indicating good creditworthiness. Bottom line: a higher score means creditors will be more likely to lend to you and at more favorable terms.

Of the five components factored into the calculation, each impacts your credit score to a different degree. Your payment history and your current debt are the most heavily considered in determining your credit score, combining for about 80% of the total calculation.

Think of your payment history like this: if you were interviewing a candidate for a job, you would want to know if

Want a Higher Credit Score? Follow These Tips!

- ☑ *Check your credit report for errors*
- ☑ *Pay all your bills on time*
- ☑ *Pay more than the minimum due on credit card balances monthly*
- ☑ *Pay off credit cards in-full each month*
- ☑ *Keep credit card balances low—always use less than 25% of your credit limit. To really push your score, use no more than 5% of your limit!*
- ☑ *Don’t open new accounts too rapidly—apply for and open new accounts only as necessary*
- ☑ *If rate-shopping for a loan, keep inquiries within a focused period of time (i.e. two weeks)*

Further Reading on Credit Scores

>Credit Report vs Credit Score:
https://finances.extension.wisc.edu/articles/credit-report-vs-score/

>About FICO & Credit Scores:
https://www.myfico.com/credit-education/credit-scores

>Credit Inquiries:
https://finances.extension.wisc.edu/articles/credit-inquiries/

>Guide to Improving Your Credit Score:
https://finances.extension.wisc.edu/files/2020/11/Credit-Scores-handout-5.18.pdf

>Security Freezes & Fraud Alerts:
https://finances.extension.wisc.edu/articles/security-freezes-and-fraud-alerts/

>Credit Check Toolkit:
https://finances.extension.wisc.edu/articles/credit-check-toolkit/

>Get Your FREE Credit Report:
https://www.annualcreditreport.com/

If you think you have been a victim of identity theft, file a report with the Federal Trade Commission online at: www.IdentityTheft.gov

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they have any experience, how much, and how well they performed. Your payment history serves the same purpose; a long history of making on-time monthly payments on all debt will result in a higher score.

Your current debt on all accounts is another important factor in calculating your credit score. Additionally, the amount you've borrowed is compared to the total amount of credit available to you. This ratio reveals how consistently you are able to successfully manage and repay debt. Regularly maxing out a credit line will indicate that you may be over extended, which will lower your credit score.

Simply taking an intentional approach in managing your payments helps build a strong history of responsible borrowing. While payment history may be the most important factor in your credit score, it really boils down to how you manage your available credit – building good habits is essential to establishing and maintaining a high credit score.

Other factors play a small role in your credit score, like new credit and the types of accounts. New accounts aren't always bad, but opening several accounts in a short amount of time will represent greater risk to the creditor, which will lower your score. This is especially true for people with limited or no credit history.

When you apply for new credit, it appears on your credit report as a hard inquiry. Credit scoring takes into account how many, how frequently, and how recently these inquiries appear on your report. If you are applying for a loan, you can still shop around for the best rates by applying to multiple lenders – inquiries related to the same type of loan (for example, all auto loan inquiries) will be counted as one or zero inquiries if they are all made over a short period such as two weeks.

The types of credit accounts, or your credit mix, also has a small impact on your score. Your credit mix includes revolving accounts like credit cards or retail accounts, and installment accounts like mortgage, auto, or student loans. Having a payment history that shows successful management of different types of credit will help to increase your score. However, if you have a diverse mix of accounts with a poor payment history, the negative payment history will have more impact.

That's it! Credit scores depend mostly on your payment history and amount of debt, with new credit and types of credit also playing a minor role. Follow our tips to improve your credit score and stay tuned for the next issue of Funding Your Future to learn about budgeting.

Sources: https://finances.extension.wisc.edu/article-topic/building-and-maintaining-credit; https://www.myfico.com/credit-education/credit-scores

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