REALTY TIMES®

February 16, 2011

Explaining Credit Scores

by Carla Hill

Have you ever wondered what makes up your credit score? The three major credit reporting agencies, Experian, TransUnion, and Equifax, use a number of factors to calculate your score.

Credit scores range from 300 to 850 and are a buyer's key to attaining loans. From cars and homes to everything in-between, if you need a loan, you need good credit. The way it works is simple. A high score is a door to lower interest rates and larger sums of credit. The higher your score, the less of a risk your pose to a lender, and therefore the more likely they'll be to approve you for a loan.

The score is compiled by analyzing the following:

1. Length of Credit History: The longer you've had credit the better. The agencies will be looking at the time that's passed since accounts were opened, the time since account activity, and then the time passed since accounts were opened based on what type of accounts (myfico.com).

2. Payment history: Do you make your payments on time? Have you missed payments or filed for bankruptcy? If you've defaulted on an obligation, your credit score will drop. On the other hand, if you pay faithfully each month, your credit score will rise to reflect it!

3. Percent of Credit Used: Think of it this way. You have two lines of credit open with credit limits of $5,000 each. That means you are able to use a total of $10,000. If you have a $2,000 balance on one card and $3,000 on the other, you are using 50 percent of your available credit. The smaller percentage you are using the better. Fifty-percent is very high.

Many people ask if they should close an unused card. If you are paying monthly or yearly usage fees to the credit card company for a dormant card -- then the answer is probably yes. But keep in mind, if you close one of those $5,000 credit limit cards, your new credit limit is just $5,000. If you now are using $3,000 of your $5,000 limit, you are using 60 percent of your available credit. This is bad news for your score.

And on top of this, how much do you owe total? If you are carrying a large amount of debt, banks and lenders may see you as at risk for default. This means no new loan for you.

4. New Credit: Have you recently opened several new accounts? This is a red flag of risk to lenders. They'll wonder if you're on a spending spree and about what other lines of credit you'll be opening alongside theirs.

5. Types of credit: According to some experts, it is good to have more than one type of credit open. This means to have some credit cards, a mortgage, and installment loans.

6. Settlements: Did you default on a loan? Have you filed for bankruptcy or foreclosure? Did you reach a settlement with a credit card company? These factors will lower your score dramatically, as they show you are a risky borrower.

7. Errors: From identity theft to clerical errors in reporting, mistakes on your report can cost you. You are allowed to view your report three times a year at myannualcreditreport.com. Check it often to ensure accuracy.

Will a low score haunt you forever? Have no fear, your credit score changes over time. It will rise if you are a responsible spender and make your payments on time. Your credit score truthfully reflects your credit history. So, the power to change it is in your hands.
