Understanding Credit

The Five components of Credit Scores

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Credit bureaus collect a series of information that composes a credit report. A credit report has personal information and financial decisions that have been made by the account owner, that's you! A credit report has your name, birthdate, social security number, current employer, employment history, homeownership, income, previous addresses, and creditors who have requested information on your behalf. Based on open lines of credit, your credit score is composed of five pieces of pie.

New Credit – 10%

Establishing credit can open many financing opportunities. Establishing and maintaining good credit rating is crucial in obtaining reasonable interest rates. Opening a new line of credit can affect up to 10% of an applicant's credit score. Opening a credit card, line of credit, or vehicle financing is not bad. However, when an applicant has too many inquiries in a short period, not only does it drop an applicant's credit score because of hard inquiries, but lending institutions can interpret it as a sign of credit risk. It is recommended to space out credit applications for at least six months or longer. If you are considering purchasing a home, avoid applying for new credit at least six months before starting the home-buying process.

Length of Credit History – 15%

Credit history is based on the average age of open credit lines. The longer the credit history, the better the credit score. Closing an account can affect credit length history, especially if the credit line is the oldest. The same rule applies when a new credit line is open. Opening a new credit line lowers the average age of all open lines of credit available and, thus, reduces the account owner's credit score by up to 15%.

Credit Mix – 10%

Credit Mix on a credit report is when there is a variety of open credit on a credit report. Two types of credit are revolving credit and installment credit. Credit cards and home equity Lines of credit are examples of revolving credit. Revolving credit is when the borrower can borrow as much or as little up to the available credit limit. It has a flexible repayment plan based on how much the borrower has borrowed. Yet, mortgages, car, and student loans are prime examples installment loans. Installment loans have a specific payment amount for a set amount of time.

Amount Owed – 30%

Credit reporting agencies calculate the amount owed by dividing the available credit. The number is called the credit ratio. The amount owed on credit has a 30% impact on credit reports. It is essential to keep revolving credit balances below 30%. Closing unused credit cards will reduce the amount of available credit and increase the credit ratio, affecting and decreasing credit scores.

Payment History – 35%

There are no quick fixes on a payment history when we default on a payment. Those who promise to erase ***accurate negative*** information from credit files are scams. They can't deliver those promises! Only time and making on-time payments will improve your credit report. Accurate negative information can stay on your credit report up to 10 years.