HOW TO BUILD A CREDIT SCORE

Credit scores came into existence to protect lenders but it can also help you, the consumer. But understanding them can be a bit confusing.

Below we break down the difference between a credit score and report, how to improve your credit score and why it matters.

What Is a Credit Score?

A credit score is a number that represents how likely you are to pay bills on time, as well as repay any outstanding loans.

This number is calculated based on factors such as the length of your credit history, the number of accounts you have open, your total level of debt and your repayment history. Other factors may be considered depending on the agency that calculates your score.

A credit score ranges from 300 to 850. A higher score tells third parties that you're more likely to pay them what you owe. A lower score represents a higher risk that they will either be paid late or not at all.

In the U.S., there are three major credit reporting agencies who use information they collect to determine your credit scores. These agencies are Experian, Equifax and TransUnion.

Each agency uses its own calculations and criteria for determining your score. They may also have incomplete information regarding your credit history. Because of these factors, your three scores may vary.

One type of credit score, called FICO®, takes all three of these scores, as well as your complete credit history, to come up with a final score. Many companies prefer to use this number when determining your credit worthiness.

What Is a Credit Report?

A credit report is a detailed record of your current and past debt.This report focuses on your history of repaying these debts.

It is slightly different from your credit score. A credit score is solely a number and it's calculated based on the information from the report.

The credit report provides the details of your borrowing history. It will include:

- The names of companies that have lent money to you
- The amount of each loan
- The amount of the payments
- If your payments for these loans were late
- How much debt you still carry

It will also include personal information about you such as your social security number and date of birth. This helps the credit reporting agencies distinguish you from other people who have the same or a similar name as yours.

A credit report may also include:

- Your past addresses
- Your current and past employers
- A list of business that have recently obtained a copy of your report
- Certain public information, such as if you claimed bankruptcy
- Any accounts that have been turned over to a collections agency

The purpose of this report is to give potential lenders a better idea of how likely you are to pay them back. If they see a lot of debt or missed payments on your records, they may not lend you the money you want.

On the other hand, if you have a history of paying on time, they are more likely to give you a loan.

How To Build A Credit History

Most American adults have some sort of credit history, whether that’s through an auto, home or student loan or by using a credit card.

If you’re someone who lacks a credit history, you can use one or more of these methods to get started:

Co-signer--If you can have someone cosign a loan for you, this is a great option. But should you not repay the loan, the cosigner will have to pay it back.

Secured credit card--This is a type of credit card that is backed by a deposit. The issuer of the card usually requires that you make a deposit with them for the same amount as the credit limit. Should you not repay the loan, they will keep the deposit.

Credit for paying rent--Companies like Rent Reporters and Rental Kharma will report your rental history to the credit reporting agencies. Sometimes this reporting isn't accepted by the credit reporting agency but if it is, you can use it to help you get a loan or credit card, which will help you establish a credit history.

Credit-builder loan--Sometimes a bank or credit union will let you borrow a small amount to help you establish credit. In this situation, the institution holds onto the loan until you repay it.

Free programs--There are programs that can attach your utility payment or banking history to your credit report. UltraFico and Experian Boost are two free programs that do this.

Why a Good Credit Score Is So Important

Once you have established a credit history, you will want to keep your score as high as possible. Having a higher score will make your life easier and more enjoyable. You will be more likely to get the lifestyle you want, such as your dream home or that new Mercedes. It will also save you money in the long run.

Credit scores and reports are used everyday, by many companies. Your credit score or report may be pulled when you apply for any of the following:

- A home loan
- A student loan
- An auto loan
- Utilities in your name
- An apartment lease
- A new checking account
- A new job
- An insurance policy

All of these organizations feel more comfortable conducting business with someone who has a high credit score. If your credit score is low, you may be denied for a loan, credit card, or an apartment lease, and utility companies may require a deposit from you.

In some cases, they may be willing to give you what you want but only if you provide a larger down payment, fill out additional paperwork or can find a cosigner.

They may also charge you a higher fee or interest rate. For example, a mortgage company may give you an interest rate of 4% if your credit score is above 750 but bump it up to 6.5% if your score is below 650. This means you will pay more interest in the long run for the same loan.

As for a potential employer, they may want to view your credit history to ensure they're hiring someone who's responsible. If you're financially responsible, they will view it as reassurance that they're hiring someone who is honest and reliable.

How to Increase Your Credit Score

Since over 90% of top lenders use FICO® scores to determine credit worthiness, we should look at how their algorithm breaks down your credit history:

- Payment history (35%)
- Use of credit (30%)
- Length of credit history (15%)
- Credit mix (10%)
- New credit inquiries (10%)

Since payment history and credit usage make up 65% of your score, this is where you should focus first.

Payment history is just as it sounds--the history of your payments on any debt. It shows whether or not you made your monthly payments and if you paid on time. If you have a history of paying late, your score will be lower.

Paying your bills on time is one of the best ways to raise your score. Some tips to pay on time is to create a system for your bills and paperwork, and to set up auto-debit for recurring payments. You can also set reminders in your phone and pay the bill immediately when the reminder pops up.

If you're struggling to pay a bill, try calling the company to negotiate a smaller monthly payment that's stretched out over a longer period of time. A lot of companies will work with you when you're able to make a reduced payment and this is much better for your credit score versus not paying at all.

Use of credit is the amount of total credit you're using versus the amount you've been given.

For example, if your credit card company sets your credit limit at $20,000 and you're averaging just 2K a month in charges then you're only using 10% of your available credit. This would boost your credit score. On the other hand, if your credit cards are maxed out, then your score will take a serious hit.

The best way to boost this portion of your credit score is to not borrow the maximum amount the lenders grant you. Borrowing to your limit will not only lower your credit score, but it can have a negative impact on your entire finances.

Length of credit history means how long you've had your oldest credit card or loan. The longer you've had it, the better your score. Keeping the same credit card for many years is one easy way to improve this part of your credit score.

Finally, **credit mix** and **new credit** have to do with the type and total number of your accounts. Too many accounts may indicate that you don't have control over your finances. On the other hand, too few accounts (or accounts of the same type, such as two auto loans) won't give potential lenders an idea of your ability to pay off different types of debt.

Most lenders like to see a history of two or three types of monthly payments paid on time and in full. This can be accomplished in a number of ways, such as successfully paying a credit card bill and mortgage each month or paying both an auto and student loan.

The key is to borrow only what you can easily afford, then pay the monthly charge in full and on time. If you do that, your credit score--and lifestyle--will gradually improve.