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Great Credit
Requires More
than Paying
Bills on Time

Credit Makeover

by Edward Jamison, Esq.

A lot of homeowners have the mind set that making payments on time automatically equates to good credit and credit scores. Unfortunately, this couldn't be further from the truth. While paying your bills on time accounts for a large portion of your credit score, there's still a lot more to it. In fact, paying your bills on time only drives 1/3rd of the points in your credit score, which means that 2/3rds of your score has nothing to do with making on time payments. Five main categories go into your overall credit score calculation. Let's briefly review each category and how much they count:



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1 Payment History — Most Important Category

This category is pretty self-explanatory. It doesn't take a rocket scientist to figure out that if you pay your bills on time, you'll do well in this category. Likewise, if you have a history of late payments, collections, charge-offs, public records, etc. — you're not going to do so well in this category. In addition, the number of negative items on your credit reports is important. The more incidents of credit transgressions, the more your score will suffer. And if you have recent negative information that will punish your scores more than if they are several years old.

2 Debt — A Very Close Second

The most important non-payment category in your credit score is, by far, the amount of debt that you carry. And while your installment debt (auto loans and mortgages) are factored into your scores, it's really your credit card debt that's most important.

This includes anything from Visa, MasterCard, Discover, American Express, gas cards and/or retail credit cards like Macy's or Target. The balances that you carry on your credit cards can affect your scores

almost as much as whether or not you make your payments on time. This category calculates the proportion of balances to credit limits on your revolving credit card accounts — also referred to as 'revolving utilization'. Simply put, the higher your revolving utilization percentage, the fewer points you will earn in this category.

To determine your revolving utilization, you'll need to

add up all of your current balances and all of your current credit limits on your open revolving credit accounts (except for Home Equity Lines of Credit). This will give you a total balance and a total credit limit. Divide the total balances by the total credit limit and then multiply that number by 100. This will give you your total revolving utilization percentage. See the example provided below:

$$\begin{array}{rcccc} \text{Total Balances} & \text{Total Limits} & \text{Total Revolving} & \text{Utilization \%} & \\ \$12,000 & \div & \$25,000 & = & 0.48 & \times 100 & 48\% \end{array}$$

Remember, the lower your utilization percentage, the more points you'll earn and the higher your credit score will be. While 50% is better than 60%, 40% is better than 50% and so on.

3 The Age of Your Credit History — Secondary Category

Don't confuse this with your age. It's the age of your credit reports. Basically, the score is looking to see if you have a lengthy history of managing your credit obligations. The age of your credit history is determined by the "date opened" on the oldest account listed on your credit report. The older your credit report, the more points you will earn in this category. There's really not much you can do in this category except wait it out. As your reports get older, you will gradually earn more points. This means that you should never try and get old, good accounts removed from your credit reports. You want the history!

4 New Credit/Inquiries — Secondary Category

When you apply for credit you are giving the lender permission to pull your credit reports and credit scores. Each time this happens, your credit report will reflect what's called an "inquiry." To perform well in this category, you should really only apply for credit when you need it.

5 Credit Mix — Secondary Category

What types of accounts do you have? You will do well in this category if you have a nice diverse list of different types of accounts in your credit report. This includes mortgages, auto loans, installment loans, credit cards, etc. If your credit report is dominated by one type of account (or lack of others), this could negatively affect the number of points that you earn from this category.

That pretty much covers the factors that are used in determining your credit scores. Let's do a quick recap:

1. How you pay your bills — on time is good, late is bad
2. How much you owe your creditors — keep your credit card debt low (10% utilization is optimal)
3. How long you've had credit — the longer the better
4. How often you apply for credit — apply only when you really need it
5. Account mix — diversity is good

If you can stick by these five key principles, you should be well on your way to healthy credit and credit scores. ■



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One of the greatest compliments I can receive is a personal referral to one of your friends who may benefit from professional mortgage planning services.