Are You Managing Your Credit Score?

By Charlotte Malone

If you are looking to rent an apartment, buy a home or finance a car, you are going to need to know your credit score. Credit scores are a way of measuring how well you manage your debt and how confident lenders can be that you'll pay them back.

So, what's a good credit score, and how do you get one?

The most used scoring system is called FICO, named after the company that compiles the reports, and ranges from 300 to 850. On this scale, higher is better, and anything over 700 will usually get you lower interest rates. With a score lower than 650, there's a potential to be rejected from loans and credits cards or pay very high rates for them.

FICO doesn't share all the details about how it calculates scores, but it says that the weights for the criteria it uses are: 35% payment history, 30% amount owed, 15% length of history, 10% new credit, and 10% types of credit used.

Let's look at each of the criteria.

Payment history: Payment history is a record of whether you've paid your bills on time. As long as you aren't consistently missing payments on your current credit cards or loans, then this number should be pretty high. An easy way to make sure you never miss a payment is to set up a reoccurring monthly bill pay for either the minimum or current balance due on each account.

Amount owed: This number is the percentage of how much of your allowed credit you are currently using. For example, let's say you have a single credit card with a $1,000 credit limit. You have a $200 balance on this credit card of the allowed $1,000, so your amount owed would be $200/$1,000 or 20%. Ideally, you should be utilizing less than 30% and no more than 50% of your total credit. If you find yourself using a large percentage of your credit, consider increasing your credit limit on your current cards or obtaining and additional credit card. If your card company will not allow you to do either, work on paying down your current amount owed.

Length of history: This is the average age of all your accounts and how long it has been since you used each one. Here, the longer the history the better your score. For this reason, it is usually best to not close your credit cards. After you close a card, its history vanishes, and if you'd held that card for many years, it no longer contributes to your length of credit record. Exceptions would be cards that were previously jointly held with an ex-spouse, in which case you would no longer want them attached to your name or score. For cards with high interest rates that you no longer want to use, it is helpful to put on a small reoccurring charge, like Netflix or a newspaper subscription, and then set the credit card to be automatically paid off in full each month. This way, you don't get charged the high interest rates you were trying to avoid, and you still contribute to your credit score.

New credit: Sometimes new credit can help, and sometimes it can hurt. If you open a lot of new lines of credit all at once, it is going to hurt your score and decrease your length of credit. However, opening a new line every couple of years will show that you are actively using your credit, but not reaching your limits of credit.

Types of credit: Having different types of credit shows lenders you can manage different kinds of accounts responsibly. A diverse mix might include a mortgage, student loans, auto loans, and credit cards. You can take a peek at your credit score in a number of ways, and often it is free to do so. If you use Mint for example, the service updates your credit score every 6 months. At the time, it gives you reasons why your score looks the way it does and tips about how to improve it. Some banks offer credit score reviews, like Bank of America, that update every few months. Other sites like FreeCreditReport and CreditKarma also give you insights to your score, but be careful if they ask for your credit card number – you do not need to give a credit card number to learn your credit score.

Bottom line:

Credit scores are an important tool when it comes to borrowing money so it is important to understand how it is calculated and where you stand. A final word; if you find you have a low score, do not fret. Scores change pretty quickly, and as long as you follow these tips to increase your score, you'll see progress.

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