



BUILD UP YOUR CREDIT

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Great credit scores are a tremendous asset that will save you money and lead to numerous other benefits. Loans and credit cards can actually help you build great credit. However, if used incorrectly, they can destroy your credit. Read on to find out how to build great credit.

WARNING! The underlying principle behind this article is something that you must embrace to live your best life—whether you get credit cards or not. The principle I'm addressing is wisely budgeting your money, along with saving some of all you earn and **not living beyond your means**. Some people recommend that younger people don't get credit cards because they're worried they may use them irresponsibly and end up buried in debt. That is understandable given the alarming number of people who are in over their heads in debt. However, to say don't get credit cards to avoid being overrun by debt only addresses the symptoms of the disease and not the disease itself. In other words, bad credit management is not the essence of the problem. It's just a symptom of a bigger problem; a problem that consists of bad spending habits and other detrimental financial tendencies. These tendencies result in choices that ultimately are a byproduct of sacrificing long-term benefits for short-term gratification (at least in most instances of bad credit).

If you habitually mishandle your finances, you're going to yield negative results in your life whether you do or don't obtain credit cards. Furthermore, if a person's spending habits aren't in check, whether he gets credit cards at age 18 or age 38 (or any other age) he's likely going to use them unwisely. (I personally know a person who didn't get his first credit card until he was almost 70 years old and is currently deep in credit card debt. As a matter of fact, some of his creditors have called my house looking for him. Don't get me started. That's a whole other story.) Anyhow, it's not about avoiding credit cards for fear of bad debt. It's about learning to budget, save, and wisely spend your money. If a person does this, credit will be a great asset and credit cards will be a tool used to build credit and harness other benefits. Educating yourself about credit is vital. I myself still have a lot more to learn. In any case, if a person doesn't learn to save, budget and spend within his or her means, postponing getting credit cards isn't likely going to help him or her in the long-term. It's only going to postpone the inevitable.

Prevention is the Best Intervention

Remember, when it comes to bad credit—just like with most illnesses and problems—prevention is key. It's usually easier to prevent a problem or disease than get rid of it once you have it. This definitely applies to bad credit; so do everything in your power to build and maintain great credit so you may harness the power of what can be a great tool.

Collaborate to Create a Great Fate

For the parents out there reading this article, I want to inform you that you can take a proactive role in helping your children build great credit scores. One thing that parents can do to help their kids learn to manage credit is to open joint credit card accounts with them or engage in some of the other arrangements that allow for parents to receive a copy of their children's credit card charges. Most credit card accounts allow you to designate other authorized users and provide them with their own cards. That way, as a parent you can supervise your child's use of credit. (I do have to warn you should be willing to cut the card off if the child doesn't use it responsibly.)

Another scenario you could exercise is to pay your child's credit card bill as long as he or she stays in a certain limit (this will provide them with a source of spending money and simultaneously help them to build positive credit). Parental supervision allows for assisting children in building great credit scores and developing positive money management habits. In the case that the child does go overboard, it opens up opportunity for discussion that can lead to learning and improvement.

Be Proactive, Not Reactive

SPECIAL ANNOUNCEMENT: To build great credit you have to be proactive. It's not automatic—paying all your bills on time might not be enough.

College students often make one of two mistakes when it comes to credit: (1) they get credit cards and spend excessively; or (2) they don't get credit cards at all. If you want to maximize your credit scores, not having any credit cards can be harmful to this goal.

If you have just started (or will soon be) attending college upon graduating from high school, chances are you will be offered credit cards for the first time. Once you're at least 18 years old and on your own, there is really nothing to stop you from obtaining credit cards through some of the many introductory credit card offers specifically designed for young college students. This can be good or bad—depending on your choices and perspective. It can be bad if you run up your credit and become deeply indebted with large balances that continuously and greatly increase over time due to very high interest rates. On the flip side, accepting the offers can be great if you

effectively and wisely manage your credit. Despite the high interest rates, the offers are generally good because they present one of the relatively few times where people have creditors acceptingly offering them credit even though they have no established credit history.

Many key purchases in life, such as that of a house or car, usually require taking on some form of personal debt. One of the primary gauges used by finance companies when gauging the credit-worthiness of a person applying for a car loan or house mortgage is his or her credit history. **Newsflash!** Credit cards usually make up a dominant and far-reaching component of one's credit history. Thus, if you have no credit cards, it can be hard for companies to really judge your credit worthiness. **Think about it**, how can someone determine how you will handle borrowed money if you've never borrowed any? Therefore, having no credit is often as damaging as having bad credit. Taking this into account, it seems like a no-brainer to get credit cards. It can be, however there is a catch.

If You Don't Manage Your Spending, Your Spending Will Manage You

The unfortunate thing that happens when many people obtain credit cards is that they don't manage them effectively. As a result, they find themselves in a hole that it is hard to get out of. However, if you're fresh out of high school, just entering college and still in your teens or early twenties, it's ideally one of the best times in life to get credit cards. Why? Because building a strong credit history that results in the highest possible credit scores takes time. In fact, one of the key components of great credit is the length of your credit history. Hence, it's not good enough just to show that you've managed your credit responsibly for a year or two. You want to show that you've managed it responsibly over an extended period of time.

When I started college I instinctively knew that I didn't want to fall into the credit card trap (unfortunately, some of my peers didn't agree with this and haphazardly charged hundreds and even thousands of dollars of debt on their credit cards; they accumulated debt for items such as clothes, *Play Station* games, and music CDs even though they were barely half-way through their freshmen years). However, my point of view led me to almost fall into the same trap as many people who take on my view, which is I didn't get any credit cards. Fortunately, one of my mentors pointed out the importance of having an established credit history and how having no credit history can be similar to having bad credit when it comes to getting things such as car financing and house mortgages. My mentor's advice especially hit home since I had no credit history at all, as I didn't even have a student loan or any type of revolving credit. Fortunately, I was still relatively early in my college education so I was able to sign up for a credit card and progressively build my credit history over time.

As a young college student, I had no problem acquiring a credit card, although it was one designed for students so it had a very small credit limit of \$300. The small limit was fine as I was concerned with building credit as opposed to charging purchases. At first I would barely charge things on my card, but then I found out (as I will show in-depth later on) that a big part of building credit scores with a revolving line of credit (such as a credit card) is regularly using it.

Great Credit Equals Great Terms When Buying a Home

Building credit goes hand in hand with getting a college degree. Say you want to buy a house or car after you graduate; the quality of the financing deal you make will greatly be determined by your credit scores. For instance, high credit scores directly translate to lower interest rates on mortgages, which over time can translate to considerable sums of money. For instance, at the time of this writing, myFico.com calculated that for a \$150,000 30-year fixed-rate mortgage, the monthly payment for a person with a top tier score is \$852 per month, whereas the monthly payment for someone with a low tier score (one that is still high enough to at least qualify for a mortgage) is \$1,007 per month. **Think about it**, \$1,007 per month vs. \$852 per month. This considerable monthly difference adds up tremendously over time. **Please never forget the old but very true adage**, “a penny saved is a penny earned.” I like to look at it as “a million saved is a million earned.” Some of the other benefits reaped by people with high credit scores when it comes to buying a home are not having to put any money down, 100% financing, low interest rates and even “**no document**” loans. “No document” means with high credit scores many companies will provide a no-income, no-asset loan, which means they don’t have to verify assets or income since it’s solely based on the credit score.

Ready to start building that great credit score? Well you’re at the right place at the right time! Explained below are the various components of one’s credit score, their relative importance and weight within the score, and how you can effectively manage them to build your credit.

FICO – The System That Determines Where You Stand

The pre-eminent scoring system for credit is administered by the **Fair Isaac Corp.**, which created the **FICO** scoring system that lenders often use to measure an individual’s credit-worthiness. To purchase pretty much anything on credit in the United States, one must have a respectable credit score between 620 and 680. To obtain something using credit on the most favorable terms, a person at least needs a credit score of 700 or more. According to Fair Isaac, the FICO score is used in 75% of residential mortgage applications. Read further to find out the components of your credit score.

FIVE COMPONENTS OF CREDIT SCORES

Payment History – 35% of total score

Paying your bills on time is indeed a key part of having good credit. Most who pay on time will have a good score; most likely ranging from the mid to high 600s. Time is the only thing that diminishes the negative impact of late payments. Therefore, the more recent the late payments, the more points that are taken away as a result. Additionally, having late payments on different accounts is more harmful than only having one account with a late payment. The moral of the story is that paying all of your bills on time goes a long way toward building and maintaining a high credit score.

Amounts Due – 30% of total score

This entails your outstanding debt balances as a percentage of all the credit to which you have access. Hence, paying minimum payments every month is often not enough. **Besides, most minimum payments on credit cards are designed to have you paying interest on your balances for a very long time.** So, even if you're making all your monthly minimum payments you will still have a low score if you have high balances. The FICO score favorably rewards those who use a relatively low amount of their credit limit. Although the amount varies depending on the source, a good rule of thumb seems to keep your outstanding credit card balances to less than half of your credit limit.

Duration of Credit History – 15% of total score

A person who has say 20 years of responsible credit use will score higher for the duration of his or her credit history as opposed to someone who is younger and maybe has just graduated from college. That's why (as long as you don't have excessive amounts of credit cards) it can usually be harmful to close credit card accounts, even if you don't use them. This is because, as mentioned above, the percentage of outstanding credit card debt you have versus your total credit card debt available is a huge scoring factor. Closing credit card accounts (depending on your limit) can greatly decrease your total credit limits, which will increase your percentage of debt to total credit available.

Consider an actual instance of people who both had great credit scores reflecting responsible use. For the person with nearly twenty years of good credit, it was estimated that the longer history resulted in 100 to 140 more points.

Closing accounts also shortens your credit history, as your credit score takes into account how long you've had each of your individual credit accounts. When you close a credit card account, you take away the opportunity for the length you've had that account to work in your favor. At the same time, your credit score takes into account

how long it has been since you last used a given credit card. So even if you have had a credit card for a long time, if you haven't been using it regularly it can have a similar effect as not even having the card. For that reason, it's good to regularly use your credit cards, even if it's just a matter of charging things and paying them off in full when the bills arrive. If you open a lot of credit card accounts at once, it can greatly lower your "average account age," which is factored into your score. From a long-term perspective however, if you open several credit card accounts with the intent purpose of being disciplined and using them responsibly, they can collectively help to build your credit.

Inquiries and New Credit – 10% of total score

Whenever you open a new line of credit, it results in a short-term drop in your overall score. Additionally, when you give a lender permission to pull your credit report it causes a score drop. Thus, for a short amount of time after you take on more credit, or simply just apply for new credit, it can cause lenders to look upon you unfavorably and accordingly harm your score. However, as this only impacts 10% of your score and really only affects it in the short-term, this typically doesn't harm responsible credit users. Think about it like this, your credit score is all about your responsible use of credit over time. So, if you take out new credit, over the short-term lenders don't know if you are going to use it responsibly, as you haven't had the opportunity to prove this. In terms of applying for items such as mortgages or loans through different companies, it's best to do so in a concentrated period of time. For instance, shopping for such items at five different places within 14 days will only count as one inquiry and won't appear for at least 30 days.

Mix of Credit – 10% of total score

To obtain a high credit score, it's best to have a mix of revolving accounts and installment loans. Revolving accounts include credit cards and line of credit accounts. I was told by a credit score specialist that five is a good number in terms of the maximum number of credit cards to have (assuming one is using them all responsibly). Installment loans entail student loans, mortgages and auto loans. Hence, this is one aspect where student loans can be beneficial (assuming you're getting them by choice as opposed to out of necessity). It impacts your credit score favorably when you can show that you make the monthly payments on a sizeable outstanding loan. If you have a mortgage and/or car loan, you don't need a student loan to have a healthy mix of credit. In any event, credit cards alone won't do it in terms of maximizing your score.

FINAL MESSAGE

There's a lot to learn about building and maintaining great credit. My hope is that this article opens your mind to the importance of (and opportunities that come with) establishing an excellent credit history and—yet more important—budgeting, saving and even investing your money. While the above info contains guidelines that (if you follow them) will lead you to building great credit, there is still more to learn as there is even more to the game of building great credit and best using it to your advantage.

The following are just a few of many other things to consider when it comes to credit: *getting the lowest possible interest rates on credit cards; what to do right before you buy a house to get the best rates; being conscious of the “fine print” within credit card agreements (which can come back to haunt you if you're not aware of them).*

Furthermore, there are various other scoring systems that different entities use when it comes to assessing your credit worthiness. These scoring systems may somewhat differ from the FICO system and even contain other nuances to consider. Nonetheless, the FICO system is the most prevalent scoring system and serves as an exceptional model of guiding principles for positioning yourself to get the highest possible credit rating regardless of what system is being used. Yet, I do recommend that you strive to continually educate yourself by getting more information on this topic, as more **info** will ultimately lead to more cash **flow!**

SOURCES

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