DIVISION OF AGRICULTURE
RESEARCH & EXTENSION
University of Arkansas System

Credit Reports and Credit Scores:

What They Are and Why They Matter

Step 1. Monitor your credit report.

Check your free annual credit report at www.annualcreditreport.com. Beware of copycat sites. You are entitled to a free annual report from each of the three credit reporting companies: Equifax, Experian, and TransUnion. Check your credit report from a different company every few months to monitor your credit report throughout the year. If you find an error, notify the credit reporting company and the lender. If you suspect fraud, contact the Federal Trade Commission.

Step 2. Check your credit score.

Your annual credit report is free but you must purchase your credit score. Most scoring systems range from 300 to 850. Higher scores qualify for lower interest rates. Most consumers have scores in the 600's or 700's. Check your score at www.annualcreditreport.com. Other sites may offer a free credit score but be aware that it may differ from the scores provided by the major credit reporting bureaus. Watch out for hidden costs such as credit monitoring offers.

Step 3 Understand the scoring system.

Want to improve your score? You'll need to know what factors influence the score. The most commonly used types of credit scores are FICO® and VantageScore.

FICO® Score

FICO® Scores range from 300-850. There are no hard rules about a specific number that ranks you as a good credit risk but, generally, credit scores in the mid-700's and above are considered excellent. Credit scores in the mid-600's and below are often considered higher risk and these consumers may not qualify for conventional loans.

FICO® Scores are determined by credit payment history, amounts owed, length of credit history, mix of credit, and new credit.

VantageScore

The earlier versions of VantageScore (Model 1 and Model 2) ranged from 501 to 990. The newest versions of VantageScore (Model 3 and Model 4) range from 300 to 850.

Extremely Influential:

- *Payment History* – make regular, on-time payments.

Highly Influential:

- *Age and Type of Credit* – use a variety of types of credit.
- *Percentage of Credit Limit Used* – keep balances low, less than 30% of credit limits.

Moderately Influential:

- *Total Balances/Debt* – reduce the amount of debt you owe

Less Influential:

- *Recent Credit Behavior and Inquiries* – avoid opening several new accounts over a brief period of time.
- *Available Credit* – only open the amount of credit you need.

Step 4. Find your motivation.

Money itself is not the end goal. The purpose of money and all of our resources is to create the life you want to live. How do you envision your life in 5 years? 10 years? 20 years? What's important to you? What are your values? Money management is easier when you have specific goals.

Set short-term and longer-term goals. For financial goals, we often say that short-term goals are less than one year, long-term goals are 5 years or longer, and medium-term goals are in-between.

Write down your goals. You're more likely to achieve your goals if they are written down, stated in positive terms. Place your written goals where you can see them often.

Identify money wasters. We all have little things we do during the week that take resources away from working toward our goals. Keep a detailed spending record for an entire month. Try to write down everything you purchase and the amount you spent. At the end of the month, review your spending log/journal. Think of ways to reduce or eliminate unnecessary spending so you will have more money to use towards your goals.

Step 5. Manage debt wisely.

When used properly, debt can be used to acquire appreciating assets and can help build your credit score. However, debt can easily become a trap.

One way to check if your non-mortgage debt is too high is to calculate a debt to disposable income ratio. Add the total of all monthly debt payments (excluding mortgage); then, divide by our net disposable income. Less than 10 percent is best. Higher than 16% and you may be getting in over your head. Aim for a ratio of 15% or lower.

Here are some other ways to tell if you are managing debt wisely:

- You're able to make more than the minimum monthly payment on credit cards or you pay balances in full every month.
- You are easily able to make ends meet and pay all of your monthly bills on time.
- You maintain an emergency savings fund that is enough to cover at least 2-6 months of expenses.

Worried that you have too much debt? Make a plan for repayment. There are many options available. One method is to pay off the card with the lowest balance first, then take the money you were paying monthly toward that card and use it to pay off the card with the next lowest balance. Another method is to use all of your extra resources to pay off the card with the highest interest rate. Pay it off as soon as possible and use the money that would have gone toward that payment to start paying more on the credit card with the next highest balance. Learn more about these and other repayment options at https://powerpay.org. Use the tools and calculators on Power Pay to determine your best repayment plan.

Summary

You can make credit work for you. Monitor your credit report by checking your free annual report every 4 months at www.annualcreditreport.com. Check your credit score as needed such as when you are shopping for a loan. Understand the components that impact your credit score and use them to build your score. Determine your personal goals. Use money and other resources to meet your goals. Keep a close eye on debt and have a good management plan.

References:

- VantageScore at https://your.vantagescore.com/
- FICO® score at https://www.myfico.com/
- *Credit Reports and Scores*, Consumer Financial Protection Bureau at https://www.consumerfinance.gov/ask-cfpb/category-credit-reporting/what-affects-credit-scores/
- *All About Credit Reports,* AnnualCreditReport.com, https://www.annualcreditreport.com/yourRights.action
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- *Personal Finance;* Garman, E. Thomas and Forgue, Raymond E., Cengage Learning, 2015

Build Your Best Credit Score

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