Guide to
# Credit

Borrowing money can help you achieve many goals in life, such as owning a home, buying a car or getting an education. Before you can obtain a loan, however, lenders first check your credit history. Have you had a mortgage, car loan or credit card before? Have you made your payments on time? Do you already have other debts that may stretch your income too thin? By answering these questions, lenders can determine how much risk they are assuming when you borrow money.

## WHY CREDIT IS IMPORTANT

Your credit history helps lenders predict how likely you will be able to meet your payment obligations when you apply for a loan. Statistics from the Mortgage Bankers Association show that only a very low percentage of people with a good credit history make late mortgage payments. However, among people with a poor credit history (often referred to as "subprime" borrowers), the percentage is significantly higher.

Lenders therefore are more careful when approving loans to subprime borrowers and may charge them a higher interest rate. And lenders usually provide better rates to those with good credit. Improving your credit rating can therefore save you money on interest.

It's a bit like buying auto insurance. People with a long, accident-free driving record pay lower premiums than those who have made many claims. In a similar way, lenders offer their best rates to borrowers with excellent credit and charge more to those with poor credit. If your credit history is particularly bumpy, it may make it difficult for you to obtain a loan.

It's therefore important to understand the factors that affect your credit profile and how lenders use this information when they review your loan request. Then you can take charge of your credit and get the loan you need at a rate you can afford.

### Credit bureaus

Lenders check your credit history through credit-reporting agencies, also known as credit bureaus. These are private companies that gather credit information about people and sell it to lenders to help them determine risk. The three main bureaus are:

- Equifax
- TransUnion
- Experian

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Credit bureaus get their information from financial institutions, credit card issuers, collection agencies and public records. If you have a credit card, a line of credit, a mortgage or a car loan, chances are that your lender sends regular reports to the bureaus about whether you are meeting your obligations.

## YOUR CREDIT REPORT

When you apply for a loan, the lender will contact one or more of the credit bureaus and ask to see your credit report. While each credit agency's report looks slightly different, all contain basically the same information.

## INFORMATION IN A CREDIT REPORT

| Personal Information | Inquiry information |
|---|---|
| Your full name<br>Current address<br>Social Security number<br>Date of birth<br>Employment information<br><br>*This information is used only to identify you, not to determine your credit risk.* | *Voluntary inquiries:*<br>Requests for your report as a result of your having applied for credit.<br>*Involuntary inquiries:*<br>Requests you did not initiate, such as a credit card company inquiring so as to make you a pre-approved offer of credit.<br><br>*Anyone who accessed your credit report within the last two years is listed, along with the date the request was made.* |
| **Credit Accounts** | **Items of Public Record** |
| Credit cards<br>Car loans<br>Mortgages<br>Lines of credit<br>Other credit accounts<br><br>*It includes the dates that accounts were opened and closed, their current balances, their maximum credit limit and how often you were late making payments. Savings accounts, checking accounts and investments are not included.* | Bankruptcies<br>Foreclosures<br>Lawsuits<br>Liens<br>Wage attachments<br>Court judgments<br><br>*The information is obtained from collection agencies or government sources.*<br><br>**Consumer Statement**<br><br>Personal comments you have submitted<br><br>*This section lists any personal comments pertaining to your credit history that you have submitted, such as an ex-spouse defaulting on a joint debt.* |

**Your credit report does not include your gender, national origin, race, religion or family status.**

## YOUR CREDIT SCORE

Rather than reviewing your entire credit report, a lender may simply obtain your credit score. This three-digit number is calculated by taking the information in your file and running it through a complicated mathematical formula. The higher your score, the more attractive you'll be to lenders.

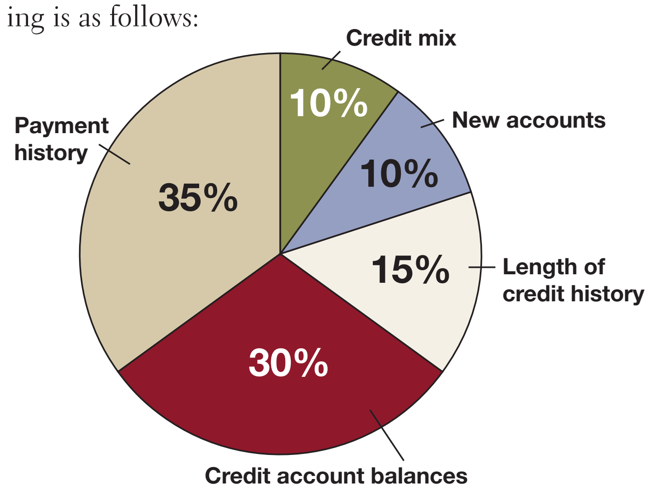
### FICO scores

Credit scores can be confusing because each bureau gives its product a different name. However, the most common credit scores are all generated using software licensed from Fair Isaac Corporation (FICO), the company that pioneered them. For that reason, you'll often hear them referred to as "FICO scores."

FICO scores range from 300 to 850, with most people falling in the 600s and 700s. In general, lenders treat a score of 760 or more as a sign of top-notch credit, while a score under 620 is usually considered subprime. However, there is no single threshold used by all lenders – some may grant a loan to subprime borrowers, while others consider only applicants with much higher scores. The key point, however, is that the lower your score, the harder it may be to find a lender, and the higher your interest rate will be if you do qualify.

Your FICO score may vary slightly between the three credit bureaus because each may have slightly different information in your file. For example, one bureau's records may have been updated more recently, or a past lender may have reported your information to one bureau and not the other two. As a rule of thumb, lenders use the score in the middle.

The FICO score is calculated using a formula that gives a weighting to five specific categories. Some categories may count for more in certain situations – for example, in the case where someone has very little credit history. In general, the weighting is as follows:






### Payment history (35%)

A lender wants to know if you have a track record of paying your debts on time. Any missed payments – especially recent ones – will lower your score, while several accounts with no late payments will raise it. This key portion of your score also includes any bankruptcies or amounts referred to collection agencies.

### Credit account balances (30%)

Lenders want to know whether you are taking on more debt than you can handle. This part of your score considers the principal on your loans and the balances of your credit cards and lines of credit. It also takes into account how much of your total credit you are using – for example, whether or not your credit cards are all "maxed out." In general, the less of your available credit that you use, the better.

### Length of credit history (15%)

Typically, people who have demonstrated that they can manage credit over a number of years will score higher than those who have very little credit history.

### New credit accounts (10%)

Lenders may raise a yellow flag if you open multiple new credit accounts or make many inquiries within a short period of time. However, the formula makes provisions for people who shop around for a loan. For example, if four mortgage lenders make credit inquiries within 14 days, that is considered one inquiry.

### Credit mix (10%)

This portion of the score looks at the different types of credit you use, such as revolving accounts, including credit cards and lines of credit, as well as debts you pay with fixed installments, such as car loans and mortgages. While it's good to have a healthy mix, it's not necessary to have one account of each type. (Traditional credit scores do not include payments of commonly recurring bills such as rent, utilities, telephone, cable TV, childcare expenses or purchase payment plans. However, for those who lack a standard credit history, FICO has developed the FICO Expansion score, which can take such payments into account.)

### Credit scores and interest rates

The interest rate on your loan is closely tied to your credit score. The better your score, the better rate you will likely qualify for. Here's an example of how things might break down:

### 30-year fixed rate mortgage $250,000

| FICO score | Interest rate | Monthly payment |
|---|---|---|
| 720+ | 6% | $1,499 |
| 675-719 | 6.5% | $1,580 |
| 620-674 | 8% | $1,834 |
| -620 | 9% | $2,012 |

These numbers are for illustration only and are based on a $250,000 loan amount, a loan-to-value ratio of no more than 80 percent, and a single-family, owner occupied home. The actual rate that you qualify for may be different.

### VantageScore

FICO scores are not the only ones available from the three major bureaus. While FICO is still the dominant brand, Equifax, TransUnion and Experian collaborated in 2006 to create their own score, called VantageScore, which uses a different formula from Fair Isaac. A VantageScore is between 501 and 990, and consumers are assigned a letter grade – for example, a score between 801 and 900 earns you a B.

If you request your credit score from any of the bureaus, make sure you understand what you're getting. A FICO score of 790 is excellent, but that same number on the VantageScore scale gives you a mediocre grade of C.

## OTHER FACTORS LENDERS CONSIDER

Lenders do more than just check your credit score when approving you for a loan. In the case of mortgage applications in particular, they will also consider:

- **Your source of income.** Lenders want to know that you have a stable income that will allow you to meet your debt obligations. If you have a spotty employment record, or if you have an irregular salary because you are self-employed or work on commission, you may find it more difficult to get approved.
- **Your debt-to-income ratio.** This is the ratio between how much you earn each month versus how much you owe. It gives lenders an indication of how much more debt you can handle. In general, lenders like to see that you're spending no more than 28 percent of your gross income (the total amount you earn per month, before any expenses are deducted) on housing (mortgage, taxes and

insurance), and no more than 36 percent on all your debt payments combined (housing plus other loans and credit cards). If your debt-to-income ratio is higher, lenders may be concerned that you'll have difficulty meeting all of your obligations.

- **Your loan-to-value ratio.** Homeowners who make very small down payments tend to be at higher risk of default. When you apply for a mortgage, the lender will therefore divide the loan amount by the appraised value of your home to obtain your loan-to-value ratio (LTV). For example:

| | |
|---|---|
| Value of home: | $250,000 |
| Down payment: | $50,000 |
| Mortgage: | $200,000 |
| LTV: | 80 percent |

In most cases, if your LTV is higher than 80 percent, you will need to obtain private mortgage insurance (PMI) to protect the lender in case you default on the loan. Some lenders also charge higher rates on mortgages with a high LTV, or, in some cases, may not approve them at all.

## WHAT CAUSES A LOW CREDIT SCORE?

Perhaps you've been denied credit or charged a higher interest rate on a loan because of a poor credit score. The first thing you need to determine is why your score is low. Here are the most common reasons:

**You have been late with loan or credit card payments.** Missed or late payments have a dramatic effect on your credit score. If you have a record of several of these in your credit file – especially recent ones – your score will suffer.

**You have too much available credit.** Do you have a tendency to apply for a new credit card every time you're offered a free gift or discount? If you have a large number of credit accounts, lenders may worry you'll overextend yourself, even if you do not regularly carry a balance on these accounts.

**Your account balances are too high.** If the balances on your plastic and your line of credit are regularly over 35 percent of their limit, lenders may worry that you'll have difficulty managing all the payments.

**You have a lot of recent inquiries in your credit report.** If your credit report shows you've applied for a lot of different kinds of credit in a short period of time, your credit score may drop. This is especially true if you have a short credit history or few existing accounts. Multiple inquiries within 14 days for the same type of loan, however – for example, if you shop around for a mortgage – are counted only once.

**You have joint accounts with an ex-spouse who has bad credit.** Many married couples are joint account holders on credit cards, mortgages and lines of credit. Unfortunately, after a divorce they are still jointly responsible for these accounts. Even if one party agrees to assume responsibility in a divorce decree, missed payments can still harm the credit score of both ex-spouses.

**There is an error in your file.** Most errors in credit files are minor and will not affect your credit score (such as the listing of an outdated employer), but others can impair your ability to obtain a loan or a favorable interest rate.

## HOW TO IMPROVE YOUR CREDIT SCORE

If a low credit score is preventing you from getting the loan you need, don't despair – there are many things you can do to improve it. However, taking hasty action can backfire and make things worse. Here are the dos and don'ts of improving your credit score:

**Do make your payments on time.** This is the single most important action you can take. If you have any accounts that are past due, get caught up and stay current. If your problem is forgetfulness, consider signing up for automatic payment programs so you won't have to remember to mail in checks.

**Do lower your credit balances.** Your score will usually be higher if your credit balances are under 35 percent of your limit. Do your best to curb your spending and direct as much money as you can to paying down what you owe.

**Do have patience.** Improving your credit score doesn't happen overnight. Depending on how you handle your debt, your score can change from month to month. However, most people won't see their score go up more than about 30 points during any three-month period. And some things can remain on your credit report for much longer than others. Defaulting on a loan, for example, can drag your score down for up to seven years.

**Don't indiscriminately close accounts.** Closing credit accounts does little or nothing to improve your score. It may even hurt, since a lengthy credit history is positive factor. If you do close one or two accounts, keep the oldest ones.

**Don't apply for more credit than you need.** While your score may be higher if you have a mix of installment loans and revolving credit, avoid opening too many credit accounts or applying for a great number of credit cards. Too much available credit can lower your score.

**Don't rush to open several new accounts after a divorce.** While it's important to reestablish your credit after a breakup, do so gradually. If you need to apply for a new car loan or mortgage, try to space out your requests by at least six months. Multiple inquiries or new accounts opened in a short period of time can lower your score.

**Don't file for bankruptcy unless absolutely necessary.** It's a mistake to believe you can "wipe the slate clean" by declaring personal bankruptcy. Bankruptcy is the worst blemish that can appear in your credit file, and it will remain there for seven to ten years.

## CREDIT SCORING MYTHS

**MYTH:** You need to pay to fix mistakes on your credit report.

**FACT:** Some companies claim they can fix your bad credit report or score. However, if the information in your file is accurate, there's nothing you or anyone else can do to change it. If your file is inaccurate, you don't need to pay someone else to report the errors, you can notify the credit bureaus yourself. Some companies charge for debt consolidation and debt management, which can in turn improve your credit score if done correctly.

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**MYTH:** Paying off debts will immediately improve your score.

**FACT:** Reducing your account balances will certainly help, but it won't improve your score overnight. Even after you pay off a collection agency, for example, the item will typically appear on your credit report for seven years. The good news is that credit scores place a higher value on recent activity, so previous mistakes eventually become less important.

**MYTH:** Credit scores discriminate against certain groups.

**FACT:** Your credit score does not consider your gender, national origin, race, religion or family status. Indeed, it is illegal for credit scores to take any of these into account. Credit scores also ignore your income level, your assets and investments, and your employment status – although lenders may consider all of these factors when processing your application.

## HOW TO CHECK YOUR CREDIT REPORT

It's a good idea to obtain your credit report from each bureau once a year. At the very least, you should request a copy at least six months before applying for a loan. That will give you time to address problems and correct errors that may appear in your file.

Federal law requires ***each*** credit bureau to send you a free copy of your report once a year upon request. You can also obtain a free report if you have recently been turned down for a loan, insurance or employment because of poor credit, or if you believe you are a victim of fraud.

The three bureaus have teamed up to make it easy for you to obtain a copy of your credit report from all three of them by contacting:

The Annual Credit Report Request Service
www.annualcreditreport.com
1-877-322-8228

You might consider staggering your annual requests. For example, you can request an annual copy of your Equifax report in January, your TransUnion report in May, and your Experian report in September. That way you'll receive an up-to-date credit report every four months. Or you can request your:

Free Credit Report and Score from
www.lendingtree.com

If you apply for your free credit report and score through LendingTree, you will also get a free trial membership in LendingTree Credit Monitoring. The service will monitor all three of your credit bureau reports daily and send you email alerts regarding any key changes.

## ERRORS AND HOW TO FIX THEM

There are several reasons why your credit report may contain errors or incomplete information:

- **You applied for credit in different names.** Perhaps on separate occasions, you applied for credit using different forms of your name. Maybe you used both your birth and married surnames, or different forms of your first name, such as William and Bill. This could result in your having two different credit files, each with its own score.
- **A financial institution made a mistake.** It's possible that an error was made when a financial institution reported your personal information or payment history to a credit bureau.
- **A credit bureau mixed you up with someone else.** This can happen, for example, when fathers and sons share a name and address, or when twins have the same surname, birth date and address.

If you find an error, notify the credit bureau immediately. All three bureaus allow you to submit your dispute by phone or online, although you may need to provide documentation by mail to support your claim. You can reach them at:

Equifax
1-800-685-1111
www.equifax.com

TransUnion
1-800-916-8800
www.transunion.com

Experian
1-888-397-3742
www.experian.com

If the error originated with a bank or credit card company – which may result in its appearing in your report from all three bureaus – your best bet is to take up the dispute with the financial institution directly. It will then send the corrected information to the credit bureaus.

Remember that you can't have negative information removed from your credit report if it's true. However, if there are special circumstances you'd like banks and credit companies to be aware of, you can add a consumer statement to your file. For example, you might explain that some of the blemishes on your report were the result of an ex-spouse abusing a joint account.

## HOW TO PROTECT YOURSELF

Stay away from companies that charge hefty upfront fees and promise to repair your credit or make your debt go away quickly. If you need help in managing debt and improving your credit, many communities offer affordable or even free credit-counseling services. You can find an accredited not-for-profit service through one of these two national organizations:

National Foundation for Credit Counseling
(301) 589-5600
www.nfcc.org

Association of Independent Consumer Credit Counseling Agencies
(866) 703-8787
www.aiccca.org

Worksheet:

# Three Steps to Better Credit

Just like getting in better shape physically, improving your credit takes time and commitment, but it can also be deeply rewarding. Here's how to get started:

## 1. Obtain your credit report and score.

Request your credit report from all three credit bureaus for free. You may also want to pay to obtain your score. Ensure that each report is accurate and complete.

| Credit Bureau | Report requested | Credit Score |
|---|---|---|
| Equifax | ❏ | ________ |
| TransUnion | ❏ | ________ |
| Experian | ❏ | ________ |

## 2. Stay on top of your monthly payments.

Make a checklist of your loans and credit accounts and the minimum monthly payment. At the end of each month, pull out your list and ensure that you've paid at least the minimum. Even six months of "paid as agreed" on your credit report can start to raise your score.

| Account | Minimum payment | Amount paid |
|---|---|---|
| ______________ | ________ | ________ |
| ______________ | ________ | ________ |
| ______________ | ________ | ________ |
| ______________ | ________ | ________ |

## 3. Reduce your spending.

You can't get debt under control without changing your spending habits. List some simple ways you can save money, for example, giving up one restaurant meal a month, or cutting back on your cell phone minutes. Add up the items and start increasing your credit card payments by that amount each month. Lowering these balances will improve your credit score.

| Type of Expense | Amount saved |
|---|---|
| ______________ | ________ |
| ______________ | ________ |
| ______________ | ________ |
| ______________ | ________ |

**Total**

______________ ________

# The LendingTree® Advantage

Thanks for trusting LendingTree to help you find a loan. We put you in control of your loan by asking lenders to compete for your business. Comparing real loan offers from different lenders just makes sense. Just like you comparison shop for other large purchases, smart consumers know a loan is no different. Except at LendingTree, we do all the work, and you reap the benefits.

## WHY IS LENDINGTREE BETTER?

- **Low rates:** Up to four offers that could lower your monthly payments.

- **Personal service:** 24/7 customer service and online tools to help you make a smart borrowing decision. Our Customer Care Consultants are available at 1-800-555-TREE to help you.

- **Our Network:** Our Lender Network has more than 200 lenders. Some are household names, while others are smaller, with regional, product or customer segment specialties that may make them ideal for you.

- **Trust:** Join the 20 million people who started their search for a better loan through LendingTree.

*Contact us:*

1-800-555-TREE
www.lendingtree.com

# Additional Resources

## WHERE TO LEARN MORE

www.lendingtree.com/smartborrower

The LendingTree Smart Borrower Center offers a range of articles about credit and managing debt.

### Additional sources of information

The Federal Reserve Board
www.federalreserve.gov/consumers.htm

National Foundation for Credit Counseling
www.nfcc.org

Association of Independent Consumer Credit Counseling Agencies
www.aiccca.org

Freddie Mac's CreditSmart consumer guidebooks
www.freddiemac.com/creditsmart

Fair Isaac Corporation
www.myFICO.com

The Annual Credit Report Request Service
www.annualcreditreport.com