Credit Score: Why Does it Matter?

Many people don't realize the importance of building and maintaining a good credit score to their overall financial well-being. Before you make any buying decisions involving credit, think about your overall financial situation and the long-term impact of living "outside your means". The cost of bad credit may be more than you realize.

What is a credit score? It is a number that signifies how likely you are to pay your bills or to meet the promise to pay that you give when you take out credit. There are different methods of calculation. Although the credit reporting companies use the same information, certain factors in an individual's credit report are weighted differently, giving you slightly different scores across the different credit reporting entities.

Why should you care what your credit score is? Credit scores are used to indicate to creditors how likely you are to honor your debts. **Credit scores are a key factor in determining both your eligibility for credit and the interest rates you will pay on mortgages, car loans, and credit cards, as well as your car insurance rates, etc.** And according to the Privacy Rights Clearinghouse, prospective employers may use credit reports to judge a person's responsibility level (eHow/creditscores-2013).

Credit scores range from 300 to 850. The higher credit score is the best. **It can lead to easier access to credit when you need it, as well as the lowest interest rates. This is because the higher credit scores lead the creditors to believe you are more likely to pay them back, and therefore less risky and entitled to a lower rate.**

Thinking about buying a home? This is where you may feel the biggest impact from your credit score. **The difference in the interest rates offered to a person in Georgia with a score of 620-639 (7.9% APR-annual percentage rate) and a person with a 760-850 score (6.279% APR) is 1.621 percentage points, according to Fair Isaac's Web site (myfico.com).** For example, on a $250,000, 30-year mortgage, that difference would cost more than $98,281 extra in interest charges over 30 years (myfico.com Loan Savings Calculator 2023)! The difference in the monthly payment alone would be about $273. When you move up to a $500,000.00, 30-year fixed mortgage, the difference would cost $196,562 and the monthly payment alone would be about $546.00 more (myfico.com Loan Savings Calculator 2023). And at certain credit levels, you may not even qualify for a home loan at all.

From a financial planning and investment perspective, the less money you are paying on your mortgage, car payment, insurance, and credit cards--the more money you should have left to save and invest for your future. This puts those with good credit scores ahead in both the short and long-term.

The way your credit score is calculated changed in 2020 under new FICO 10 and 10 T scoring*. The following are some areas that will be changing:

***Trended Data** Rather than focusing largely on the most recent months, scoring now looks back over the previous 24 months, to see whether you are reducing, maintaining, or increasing your credit balances over time. This makes it especially important to pay your bills on time and keep credit balances at reasonable levels.

***Delinquencies** A late payment will now impact you more with a bigger drop in your score than under previous FICO scoring models. Set up auto-pay to ensure at least minimum payments are made timely. Make additional payments during the month, and pay off your debt as soon as possible to lower what you spend on interest charges that increase the price of everything you buy.

***Credit Utilization** 'Credit Utilization' is the amount of your balances compared with your credit limit, and it will affect you more. Lower utilization by avoiding balances exceeding about 30% of your available credit – per card and overall. If you leave your rarely used credit cards open without using them, your score will benefit by lowering the overall credit being used.

***Personal Loans** Your score may be lowered by simply having personal or "signature loans" on your report. These are unsecured installment loans usually used to consolidate debt, with the loan money used to pay off other smaller debt balances. Debt consolidation can damage your score if you add new credit balances while still paying off the consolidated loan, or fail to apply these to lower other debt. We advise you to focus on paying down the existing debt.

Be aware of your credit score, but know what information is on your credit report, which displays the information used to calculate your score. Checking your credit report at least once a year (I recommend three times) can help prevent identity fraud by allowing you to see if someone has opened credit in your name. It also gives you a chance to identify and correct errors.

If you share a name with another family member, such as a son sharing a name with your father, you may be surprised to see errors in reporting on your record. You may also see credit that you paid off or closed still showing as active on your credit report. Typically, negative items impact a higher credit score more than a lower one. You need to challenge any inaccuracies in writing. Federal law requires negative items drop off credit reports in 7 years, but bankruptcy is an exception, remaining for 10 years.

Three major credit bureaus provide score and credit record info: Equifax, Experian, and TransUnion. The **website I recommend most is recommended by consumer advocate Clark Howard: www.annualcreditreport.com. This site allows you to request a free credit report once every 12 months from each of the three major consumer credit reporting companies listed above, giving you three free reports that you can space out through the year for monitoring purposes.**

The important message to remember is you do have control over your score through your financial decisions and how you honor your debt. Your credit score may impact your financial health, your ability to get a job, and your ability to get the things you want in life.

Roger S. Green is an independent Investment Advisor Representative offering securities and advisory services through Cetera Advisors LLC, a Registered Investment Advisor and Broker/Dealer, member FINRA, SIPC. Green Financial and Cetera Advisors are not affiliated. Roger's office is located at 3700 Crestwood Parkway, Ste. 140, Duluth, GA 30096. Visit Roger's website at www.rogersgreen.com.

*John Ulzheimer, "What You Need to Know About the New FICO 10 Scores." Experian.com. January 2020.