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FACT SHEET

What Is a Credit Score?

A credit score is, well, a score for your credit. Basically, a few different companies have some math equations that spit out a score based on how well you pay back your loans. Actually, it is based on more than that, but the end goal is to make an educated guess about how likely it is that you will pay back future loans. A high score means that other people with similar histories to you tended to pay back their loans. A low score means people like you had trouble paying back money loaned to them. This is where a bad credit score can become a little rascal.

A low credit score can make it very hard to get a loan for such things as a car, a house, furniture, or even credit cards. This makes buying big items very difficult and will cause your interest rates to be much higher on any loan you do get. Beyond that, some landlords will look at your credit to see how likely it is that you will pay your rent. You may not be allowed to rent from some locations if your credit is bad. Some employers will even pull your credit report to look at your bill pay history to decide whether to offer you a job. A bad credit score can feel like a noose choking the financial life right out of you. It is important to note that a credit score is different from a credit report. A credit report is just a list of your loans and your payment histories. Employers only use the credit report, but almost all lenders and credit card companies use the credit score. The most common credit score is known as your FICO. FICO is just an unimaginative shortening of the company's name that came up with the score (Fair Isaac & Company). The score they calculate is used by most lenders, and it is the one you probably have heard of the most.

How Your Credit Score Is Calculated

Fair Isaac's doesn't say exactly how their FICO scores are calculated, but they do give some general ideas. If you want a high credit score, you can learn how to get there by seeing what is most important in their calculations.

Over 65% of your credit score is made up of two simple measures. The first is how well you have done in paying back loans in the past. The second is the total amount that you owe to loans. You have complete control over both of these factors. You can increase your credit score simply by paying your payments on time and keeping your loan levels low, especially on credit cards. For example, if your credit cards are maxed out, you can raise your credit score by paying those down. If you have had trouble paying them down in the past, you still want to keep up payments now. Your credit score will get better as the number of on-time payments increases compared to those where you were late.

Credit Cards and Your Credit Scores

Over 40% of credit card owners get into debt by buying things they don't need. Credit card debt is, on average, over $15,000 for each household in the United States. In a perfect world, you could use a credit card to buy necessities, pay it off every month, and that would increase your credit score. History has taught us that credit cards are often used to borrow more money than can be paid back. This harms your credit score by increasing the amount owed (30% of the FICO score), and if you are late paying it back, it harms it in the payment history (35% of the FICO score). In short, if you can use a credit card responsibly by paying it off every month, it can increase your score. If you are tempted to use it to buy too much and not pay it back on time, it is probably better for your credit score to avoid credit cards.

What Does This All Have to Do With You?

Many people mess up their credit, feel defeated, and then just start ignoring their credit scores. They may think that something that takes years to fix is probably not really worth fixing. But credit scores are things that stay with you for life, and there is no reason to leave them low. In fact, there are tons of reasons to raise them. You may not need a car loan now, but that may change in a year or two. You may think you won't need to apply to apartments that check credit scores, but plans and lives change, and you will want a high credit score when that time comes. And the last thing you want is to be denied a job because your credit report is full of late payments. Look toward your future, and you can see many reasons to start working on your credit now. To start raising your credit score, you need to:

- Pay all of your loan payments on time.
- Pay down your revolving credit balances, such as credit cards and department store cards.
- If you can't resist the temptation of a credit card, either cancel it or call and get the limit lowered to something you can pay every month.

If you do these things, your credit score will slowly rise. If you really messed up in the past, then you can still start working on your credit. Most old debt and delinquencies do eventually fall off your credit, and you will want to have years of good money management in place when it does. Just keep it up, and your score will increase.

Resources
1. "Fair Isaac Corporation Announces Date for Reporting of First Quarter Fiscal 2016 Financial Results." FICO, FICO, 23 Jan. 2016, www.fico.com/en/newsroom/fair-isaac-corporation-announces-date-reporting-first-quarter-fiscal-2016-financial.
2. Time Staff. "What Is My Credit Score, and How Is It Calculated?" Money, Ad Practitioners LLC, 26 May 2014, money.com/collection-post/what-is-my-credit-score/.
3. Rathner, Sara. "Nerdwallet's 2017 American Household Credit Card Debt Study." NerdWallet, Nerd Wallet Inc., 2017, www.nerdwallet.com/blog/average-credit-card-debt-household/.