Reading a Credit Report Prediction Guide

In the column labeled "Your Prediction," write "True" for each of the statements below that you predict are **True**. Share your predictions with a partner. Then, read the article "Reading a Credit Report" to confirm or reject your predictions and write "True" for each confirmed statement under the column labeled "Confirmed by the Author." Correct any statements that may be **False** using evidence from the article.

Your Prediction		Confirmed by the Author
________	a. Your FICO score and your credit score are the same thing.	________
________	b. A credit report indicates how well a person has managed credit in the past.	________
________	c. Credit reports are issued monthly, so you know how much money to pay toward your credit card bill.	________
________	d. A credit score of 350 is generally considered to be good.	________
________	e. People with higher credit scores typically pay higher interest rates for credit.	________
________	f. The Fair Credit Reporting Act allows you to receive a copy of your credit report for free.	________
________	g. Potential employers and landlords may check your credit report.	________
________	h. The amount of money you owe is the most important part of your credit score.	________
________	i. Your income is not considered when calculating your credit score.	________
________	j. One of the best ways to improve your credit score is to apply for additional credit cards.	________

Reading a Credit Report

Your ability to qualify for a loan depends on a credit report. A credit report is a record of an individual's personal credit history. It is probably a good indicator of the applicant's character and whether he or she will repay borrowed money as agreed.

When someone applies for a loan, the lender will order a credit report to see how well the applicant has managed credit in the past. A credit report will tell, in detail, how much the person has borrowed, from whom, and whether the bills have been paid on time.

Credit reports are compiled by credit bureaus, which regularly collect information on millions of consumers. Credit bureaus get information from a variety of sources, including stores, credit card companies, banks, mortgage companies, and medical providers. When you fill out an application for credit, the information on that application is also sent to a credit bureau.

What Are Lenders Looking For?

Lenders look for certain qualities in loan applicants. These qualities are called the "3 Cs of Credit": capacity, character, and collateral. A discussion of each follows.

Capacity – Capacity refers to the loan applicant's ability to repay the debt in question. The basic question is "Have you been working regularly in an occupation that is likely to provide enough income to support your use of credit?" More particular questions might address the following.

- ✔ Do you have a steady job?
- ✔ What is your salary?
- ✔ How reliable is your income?
- ✔ Do you have other sources of income?
- ✔ How many other loan payments do you have?
- ✔ What are your current debts?
- ✔ Do you pay alimony or child support?
- ✔ Can you afford your lifestyle?

Character – Questions will be asked to determine whether you are honest and reliable—thus likely to pay debts. Here are some examples.

- ✔ Have you used credit before?
- ✔ Do you pay your bills on time?
- ✔ Do you have a good credit report?
- ✔ Can you provide character references?
- ✔ How long have you lived at your present address?
- ✔ How long have you been at your present job?

Collateral – Collateral refers to assets that could be sold to pay off your loan in the event that you can not do so. Collateral serves as a type of insurance for the creditor. Questions related to collateral may include the following.

- ✔ Do you have a checking account?
- ✔ Do you have a savings account?
- ✔ Do you own any stocks or bonds?
- ✔ Do you have any valuable collections or jewelry?
- ✔ Do you own your own home?
- ✔ Do you own a car?
- ✔ Do you own a boat?

The Importance of a Good Credit Rating

A *good* rating on a credit report means that, in the past, bills have been paid on time. A *poor* rating indicates overdue payments or bills that have gone unpaid.

It is extremely important to build and maintain a good credit history. A good credit report can often make the difference between getting a loan or being turned down. In addition, potential employers and landlords will often check an applicant's credit report before making a final decision about offering a job or a renting out an apartment.

Credit Reports May Contain Errors

Mistakes can and do sometimes occur on credit reports. For example, a credit report may contain information about a different person with the same name as the applicant, or paid accounts may be listed incorrectly as unpaid. The law provides individuals with a means of requesting and reviewing their credit reports and having mistakes corrected. Under the Fair and Accurate Credit Transactions Act you have the right to get a free copy of your credit report from each credit bureau annually.

The official site established by the three credit reporting agencies (Equifax, Experian, and TransUnion) for free reports is www.annualcreditreport.com. The Fair Credit Reporting Act also allows you to receive a free copy of your credit report if you are turned down for credit or are the victim of identity theft.

What's My Score?

Credit reporting agencies summarize much of the information in your credit report into one credit score. The formula for computing credit scores was developed by Fair Isaac Corporation; the scores are commonly referred to as FICO scores. The scores range from 300 to 850, with the median score being 723. People with lower scores are more likely to be denied credit or charged higher interest rates. People with scores of 770 or higher will receive the best rates for loans. Scores of 640 or more will qualify applicants for fairly good rates. People with scores of 600 or less will have difficulty getting a loan. These people probably need credit counseling.

The following chart shows how lenders use FICO scores to evaluate loan applicants. For example, the chart shows that 8 percent of borrowers have FICO scores of 550 to 599, and approximately half of them either didn't pay back money they owed or were more than 90 days late in making their payments. In contrast, 27 percent of borrowers have a score of 750 to 799, and only 2 percent of them were delinquent.

FICO Scores: Measure Credit Risk

How Borrowers Rank		Delinquency Rates by FICO Scores	
Up to 499	2%	Up to 499	87%
500 to 549	5%	500 to 549	71%
550 to 599	8%	550 to 599	51%
600 to 649	12%	600 to 649	31%
650 to 699	15%	650 to 699	15%
700 to 749	18%	700 to 749	5%
750 to 799	27%	750 to 799	2%
800 +	13%	800 +	1%

Source: Fair Isaac Corporation

Who Uses Credit Scores?

Lenders aren't the only ones who use credit scores. Insurance companies use them in their evaluations of a new client's risk. A person with a low credit score may not be able to buy insurance or will be charged a higher premium. Landlords also request credit scores when evaluating new tenants. People who have difficulty paying their bills may not be able to pay their rent on time. Finally, some employers use credit scores when screening new applicants for jobs. Employers seeking to fill jobs which require the handling of cash, or jobs paying salaries over $100,000, are especially likely to request a credit score for the applicant.

What Information Is Used to Calculate My Score?

- **Payment history (35%)**
  The most important part of a credit score is your repayment history. More than a third of your score is based on whether or not you have paid your bills and whether you have paid them on time. Most people are never late in paying their bills. So, if you are ever a late payer, even a few times, it will hurt your score.

  How late you are (whether it's 30, 60, or 90 days) makes a difference, too. An account that was late 90 days or never repaid will hurt your score more than one that was late 30 days.

- **Amounts owed (30%)**
  The second most important factor is the amount of debt you currently owe. This measure is based on your current level of debt compared to your income. It also includes a measure of how much credit you are currently using out of the amount of credit that is available to you. Many lenders will not make loans to individuals who are already spending 25 percent of their gross income to repay debt. They feel that the borrower will not have enough discretionary income to make additional payments, reliably, on a new loan. For example: A person who owes money on school loans, a car loan, a mortgage, and lots of credit card payments, totaling 50 percent of his or her take-home pay, probably wouldn't be able to handle any more debt.

  In addition to the actual amount of debt you currently owe, lenders will look at how you are currently using of the credit available to you. If you have two credit cards with a total credit limit of $10,000 and a balance of $5,000 (a ratio of 5,000/10,000 or 50%) you will be more likely to qualify for a loan than someone who has a $1,000 credit limit with a balance of $900 (900/1,000 or a ratio of 90%).

- **Length of credit history (15%)**
  The length of time that you have had credit affects your credit score. Sometimes people are encouraged to keep old accounts open with no balance just to help their credit score.

- **Types of credit (10%)**
  Lenders like to see a mix of installment loans and credit cards. However, it is much more important to pay all of your bills on time than to have variety in your credit profile.

- **New credit and inquiries (10%)**
  Each time you apply for credit, the lender will request your credit report. These requests, sometimes called inquiries, temporarily reduce your credit score. Applications for new credit following recent late payments are viewed more negatively because they are seen as a sign that you are trying to borrow to pay current debt rather than to buy a new asset.

However, there may be times—when you are shopping for a car, perhaps—when you will apply for credit at several places during a short period of time (say, 30 days) to see where you can get the best offer for a loan. These inquiries are viewed differently; they don't affect your credit score as negatively as several independent credit applications throughout the year.

What can you do to earn a good credit score or improve your score? Pay your bills on time and limit the amount of debt you take on. These two factors account for 65 percent of your credit score!

Ways to Establish and Keep a Good Credit History and Improve Your Credit Score

There are several steps you can take to establish and maintain a good credit history.

- ✔ Always pay your bills on time.
- ✔ Never borrow more than you can comfortably pay back.
- ✔ Borrow only the amount you need.
- ✔ Know how much you owe at all times.
- ✔ Contact lenders immediately if you expect to have a payment problem.
- ✔ Develop good saving habits so that you can handle financial emergencies without borrowing.
- ✔ Report lost or stolen credit cards immediately.
- ✔ Never give your credit card number or other personal information over the phone or on the internet unless you initiated the transaction.
- ✔ Open a checking account and a savings account.
- ✔ Do not apply for too many credit cards. Even if you don't use them, the credit limits are taken into consideration when you apply for credit.

Questions

a. Briefly explain the "3 Cs of Credit".

b. What is a credit report?

c. Why is it important to check your credit report.

d. How can you obtain your credit report for free?

e. What is the difference between a credit report and a credit score.

f. Breifly summarize the information used to calculate your credit score.

g. Why is payment history the largest percentage of your credit score?

h. What are some steps you can take to improve your credit score?

Your Credit Score and the Price of a Car

1. Log in to http://councilforeconed.org/earningcredit. Enter the access code you received for the Pre Survey in the box under **Returning Students.** Record the following information.

   a. Pre-Survey credit score _______ b. Lowest interest rate you would be eligible for ________

2. Assume you decide to borrow $20,000 to buy a new car. Log in to https://www.bankrate.com/calculators/auto/auto-loan-calculator.aspx to calculate the monthly payment and total cost of the loan, using the interest rate from your "simulated" Pre-Survey credit score. Assume that the principal (total amount borrowed) is $20,000 and the loan period is five years (60 months). Record the following information.

a. Estimated Monthly Payment ________ c. Total Interest Paid ____________

b. Total Principal Paid ___________ d. Total Cost of Loan ____________

3. Use the information from Questions 1 and 2 from each member of your group to complete the table.

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7
Student	**Credit Score**	**Interest Rate**	**Estimated Monthly Payment**	**Total Principal Paid**	**Total Interest Paid**	**Total Cost (Add Column 6 to Column 7)**
A				$20,000		
B				$20,000		
C				$20,000		
D				$20,000		
E				$20,000		

4. Answer the following questions.
   a. What was range of credit scores in your group?

   b. What was range of interest rates in your group?

   c. How are your interest rate differences related to your credit score differences?

   d. How did these differences affect the total cost of the car for individuals in your group?

   e. What behaviors caused some students to have lower credit scores?

   f. What behaviors caused some students to have higher credit scores?

   g. What could individuals with low "simulated" pre-survey credit scores do to improve their credit scores?

   h. Now think about the categories used to calculate an actual credit score. What kinds of behaviors would result in a low score, representing a high risk?

   i. What kinds of things can each individual do in the future to ensure that his or her real credit score is high?

Evaluating Three Loan Applications

Listed below are three loan applicants who are interested in buying a new car. Based solely on the information provided and their credit score, determine whether you would approve or decline their loan requests. There is no specific credit score for which lenders would deny a loan automatically, based only on a score. However, the credit score does provide useful information about the credit-worthiness of the individual. If you decide to make a loan to the applicant, assign an interest rate appropriate for the applicant's score. Check your response and then write the reason for your decisions. Interest rates typically assigned to various credit scores are provided on the following page.

Status codes given at the end of the reports.

JANICE BROWN				**Credit Score 450**		
Company name	**Months reviewed**	**High credit**	**Terms**	**Balance**	**Past due**	**Status**
Sears	2	2,016	24	838		R3
Dept. of Educ.	7	1,507		1,507	158	I5
Dept. of Educ.	2	512		512	512	I5
ABC Credit Card	8	3,000	29	1,363		R1
Record of Month	6			28	38	O3

________**Approve** ________**Decline** ________**Not Sure** ________**Interest Rate**
Reason for decision:

TITO SANDERS				**Credit Score 770**		
Company name	**Months reviewed**	**High credit**	**Terms**	**Balance**	**Past due**	**Status**
Hometown Bank	24	11,000	60	5,350		I1
ABC Credit Card	6	2,500	36	0		O0
Dept. of Educ.	5	2,000	24	1,380		I1
XYZ Credit Card	12	3,000	24	495		R1

________**Approve** ________**Decline** ________**Not Sure** ________**Interest Rate**
Why?

MARIA MARTINEZ				Credit Score 620		
Company name	**Months reviewed**	**High credit**	**Terms**	**Balance**	**Past due**	**Status**
Hometown Bank	13	7,200	48	5,800		I1
ABC Credit Card	7	2,000	24	488		R1

________**Approve** ________**Decline** ________**Not Sure** ________**Interest Rate**

Why?

Status Codes

FICO SCORE	APR
720-850	6.098%
690-719	7.644%
660-689	9.059%
620-659	11.761%
590-619	15.478%
500-589	16.202%

Type of account

O = Open

R = Revolving

I = Installment

Timeliness of payment

0 = Approved, not used

1 = Paid as agreed

2 = 30 days past due

3 = 60 days past due

4 = 90 days past due

5 = 120 days past due

7 = Making regular payments under wage earner plan

8 = Repossession

9 = Seriously delinquent/bad debt (paid or unpaid; charged off account)

