What you need to know before opening up a line of credit—and your credit score

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During your lifetime, there are various reasons that you may need to open up a line of credit. What's a line of credit? This is a way for you to borrow money when you need it to pay for an expense. For example, you want to pay via a credit card for household purchases, clothing, and gas. Or you may need a personal loan to buy a car, pay for education, home improvement or medical expenses. Some day you may also want to borrow money to buy a home or condo.

Typically, to borrow money, you will find a line a credit at a bank, credit card company, or other finance company. Whether you are applying for opening up a credit card, a personal loan, or a mortgage to buy a home, the lender (the company looking to lend you the money) is going to look at your credit score as a primary indicator before determining whether or not you will receive the line of credit. The credit score is an indicator of your credit worthiness. In other words, it tells the lender if you are someone who has a good history repaying your debt.

Because of this, it's important to know what things affect your credit score. To start this process, you may want to learn your current credit score. You can learn this through a free service offered by your bank or may cost a small fee through an agency. Lenders are commonly looking for your FICO credit score. Through a government sponsored program, you can get one free annual credit check at **www.annualcreditreport.com** (you can learn more about the free credit report at **ftc.gov** (the federal trade commission).

Once you know your FICO score, the following are steps you can learn how you can improve it or, if you are younger or don't have a credit score, below are the proper steps to build your credit.

Credit scores can range between 300 and 850, with 300 being a mediocre credit score and 850 being an exceptional credit score.

Typically, the main factor that affects your credit score is your past payment history. This includes your ability to make your payments on time. Someone who is able to show responsibility in making all their payments on time will show a more limited risk to the lender compared to someone who is missing payments. Most bills will show you the minimum payment as well as the full balance due. While you should be trying to pay off the full balance as soon as possible, because it will cost you less in finance costs, just by paying at least the minimum payment due by the due date will help improve your score.

The next biggest factor that affects credit score is the amount of credit you owe or are currently using. If you currently have a line of credit and are using the entire balance offered to you, this may reflect poorly on your credit score. A good rule to follow to maintain a healthy credit score is to only use up to 50% of your allowed credit.

For example, if your credit card allows you to borrow up to $10,000, you may only want to use up to half of this amount ($5,000) rather than charging the full $10,000. By following this idea, it again limits the risk for lenders by putting you at a lower chance of defaulting on your accounts.

Another factor that affects your credit score is the length of time you have had your accounts. This includes the age at which you opened up your first account, how long you've had your current accounts, and how long it's been since you've used your accounts. Typically, it's better to have had experience with using credit by having accounts that you've used for extended periods of time so that you can establish a good track record of responsible credit use.

The amount of new credit established is also another factor in determining your credit score. If you have opened up multiple new credit accounts within a short period of time, this could look risky to lenders. This commonly occurs when you are out shopping and want to open a store credit card (because of the discount they may offer). **[To learn more about the risks of store credit cards read this article.]**

The last thing that impacts your credit score is your credit mix. This is similar to diversifying your investment portfolio. Lenders often look at the mix of credit that you are currently using: credit cards, auto loans, , mortgages, loans, etc. Having a mix of credit is typically looked at as a positive to lenders but should not be something to worry about if you don't have credit in each area. Typically over time, you will naturally accumulate a more diverse credit mix.

"Overall, knowing what impacts your credit score can help you gain the best interest rates and the lowest fees when establishing a new line of credit... this makes it easier for you to pay off your debts and leaves more money in your pocket."

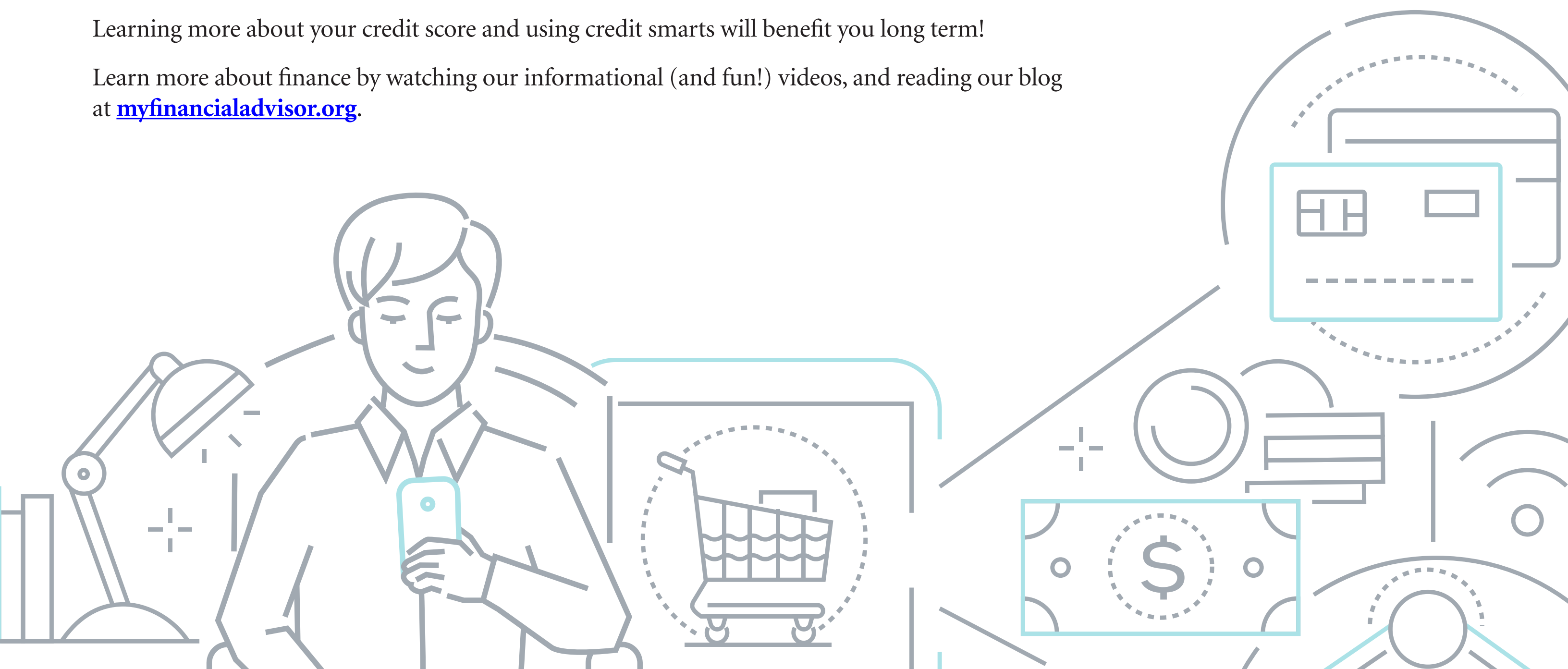
Undoubtedly, everyone has a different credit history and therefore each credit score is going to be calculated a bit differently based on the person. Outside of credit score, lenders also look at things such as your personal income, how long you've been at your current job, and what kind of credit you are requesting. Overall, knowing what impacts your credit score can help you gain the best interest rates and the lowest fees when establishing a new line of credit. Consequently, this makes it easier for you to pay off your debts and leaves more money in your pocket.

How does having a better credit score help me? The better your credit score, the lower the rate of interest you will be charged to borrow money. Just to put it into perspective based on interest rates July 2020:

- If you have a credit score of 850, you might get a mortgage loan for 3.4%.
- If your credit score is between 620 and 640, your interest rate might be 5%.
  - A difference of 1.6% in interest between 640 and 850 is a difference in over $60,000 in interest paid on a $200,000 loan.
  - So as you can see, it is always in your best interest to have the highest credit score possible!
- Lastly, if your credit score is below 620, you are likely not getting a loan in the eyes of most lenders. Yikes! You don't want a score this low.

Learning more about your credit score and using credit smarts will benefit you long term!

Learn more about finance by watching our informational (and fun!) videos, and reading our blog at **myfinancialadvisor.org**.



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