

Understanding and Establishing Credit

A credit score is a three-digit number that is calculated based on information in your credit report. It is used as an indicator to predict how you will manage borrowed money and the likelihood that you will pay it back. The higher your score, the better!

A credit score can influence different aspects of your life. A good credit score can provide you with more than just better rates. In addition to being reviewed by lenders, it's often considered when you rent an apartment or buy car insurance. Also, potential employers may request consent to review your credit score when you apply for a job.

Understanding how a credit score is calculated and how to establish and build credit is critical to financial stability.

Understanding Your Credit Score

The FICO[®] Score is most commonly used by lenders. A FICO Score ranges from 300 – 850 and there are five factors considered when calculating it. Understanding these factors and how they are weighted can help you build (or improve) your credit score.

- **Payment history (35% of your credit score)**

On-time, late, or missed payments; items in collections; and public records (like bankruptcy, foreclosure, etc.) are factored into this calculation.

Things to consider:

This factor has the biggest effect on your credit score. Set-up reminders or automatic payments if you struggle to pay your bills on time and create a plan to address any items in collections. Always stay up to date on payments.

- **Capacity (30% of your credit score)**

This considers the total amount of debt owed in relation to the capacity of your credit lines.

Things to consider:

Don't take on more debt than you can handle and keep your credit card balances low. If you have a high debt load, find extra money to put toward your debt, and develop a plan to tackle it.



- **Length of credit history (15% of your credit score)**

This factor looks at your experience with credit. It's based on the age of your oldest account, the average age of all your accounts, and how long you have used specific types of credit.

Things to consider:

A longer history provides lenders with more data to consider. If you are just starting out, be patient. If you have well established credit, keep it going. Don't close an old credit card; keep it open by making small purchases and then pay the balance in full and on time each month.

- **New credit (10% for your credit score)**

This looks at new accounts you have opened and how many hard pulls are on your report.

Things to consider:

Don't apply for a lot of credit in a short period. Consider the timing. Your FICO Score only includes inquiries from the last 12 months, so wait a year between applying for credit.

- **Mix of Credit (10% of your credit score)**

This factor looks at how well you manage different types of credit (e.g. installment loans, revolving lines of credit, and mortgages).

Things to consider:

While this factor may seem small, it can make a big difference if you don't have a lot of information on your credit report. For example, if you only have a credit card, consider a personal loan the next time you need to borrow. Adding an installment loan to the mix could help.

Visit myfico.com/credit-education for more information and check out their booklet on [Understanding FICO® Scores](#). For additional guidance in building your credit score or paying down debt, schedule an appointment to meet with a BMI Federal Credit Union Certified Financial Coach at bmifcu.org/coach.

Establishing Credit

While it seems like a catch-22, there are ways to start building credit without an established credit history. The following are ways to get started:

- **Become an authorized user**

A credit card holder may add you as an authorized user on their account (a second card will be issued to the authorized user). Payments and history will be reported to the credit bureaus for both the primary card holder and the authorized user.

Things to consider:

The primary cardholder is responsible for paying the bill and is liable for any late or missed payments. Missteps can have a negative effect on not just the primary's credit score, but also the authorized user's credit score.

- **Get a co-signer for a loan**

An individual with a good credit score and qualifies for a loan can be a co-signer for someone with little to no credit. The main borrower makes the payments, which are reported to the credit bureaus for both the borrower and co-signer.

Things to consider:

Any missed or late payments can affect the credit scores of both the borrower and co-signer. If the borrower defaults, the co-signer is legally responsible for paying the debt in full and therefore must pay any late fees and collection costs.

- **Open a secured credit card**

You do not need a credit score to open a secured credit card. Instead, you are required to put down a security deposit in exchange for a credit card (typically, the amount of your deposit is the same as your credit limit). Your payments are reported to the credit bureaus to build your credit score.

Things to consider:

You must be at least 18 to open a secured credit card. As the card holder, you are responsible for any debt and must pay any late fees or penalties if a payment is missed. Continually missing payments will cause the issuer to close the account and use the security deposit to pay off the debt. Any additional funds owed (fees and penalties) are sent to a collection agency. Not making payments can be very damaging to your credit score and your ability to secure future lines of credit.

A good credit score is a vital financial tool to help you achieve your financial goals. Credit scores can go up and down, but taking an active role in managing your credit can help you keep your FICO Score in the good (670 – 739), very good (740 – 799), or excellent (800 – 850) range.

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BMI Federal Credit Union's award-winning Financial Education Program offers resources to help. Visit bmifcu.org/education for more information.

For additional guidance on credit:

- Ask a [Certified Financial Coach](#) your questions
- Attend a [workshop or webinar](#) to learn more
- Explore our collection of articles and videos on [borrowing and credit](#)

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