

# Building Good Credit

## Consumer Alert!

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1-888-995-7856 **ALLIANCE**  
Credit Counseling

### "Credit now wears the crown in America"

Mary Rowland, former NYT finance columnist (Source: <http://moneycentral.msn.com/content/collegeandfamily/moneyinyour20s/p36954.asp>)

#### Are you interested in:

- getting a good or better job?
- getting a car or a house?
- getting good insurance rates?

The multi-billion-dollar-a-year industry of credit is a part of the answer for most Americans.



### What Is Good Credit?

Part of a dictionary definition of credit is "goods or services sold on trust" (Merriam-Webster). Having credit means that a lender trusts that you will pay them in the future as agreed. Therefore, in practice, *good credit* is defined by each lender. There are four main aspects that most lenders consider in deciding to trust you:

- ◆ **Stability.** Your length of employment and length of residence are important. Lenders will be more assured if you have a steady job with a reliable income and a permanent address for a certain length of time.
- ◆ **Ability to Repay.** Lenders want to see that you can repay as agreed, therefore, your income must be greater than your expenses. Specifically, your debt-to-income ratio – the amount of your monthly debt payments (excluding mortgage/rent) compared to your monthly take-home pay – will have to be below a certain level (perhaps 20%).
- ◆ **Net Worth.** Lenders want to know your financial net worth - the value of what you possess (assets) minus the amounts you owe (liabilities). Lenders will be more likely to extend you credit if you have something of value – a house, car, or savings account – that they can take if you don't pay. These items are referred to as collateral; they provide the lender some security for the credit.
- ◆ **Credit References.** Most lenders will look at your credit file with the national credit bureaus to get information about your credit references. Your credit file contains your history of repayment – this is one of the most important considerations. The file also includes your credit limits, your current balances, and how long you have had each account. Each credit bureau has a method for scoring your credit history and this is one measurement reviewed by lenders. These scores range from about 300 to 850 and a higher number means that you are considered to be more likely to pay back a debt.

### Why You Want Good Credit

The credit definition, cited previously, shows that credit is about trust. Naturally, you want to be considered trustworthy. Credit, then, is a privilege and a convenience. If you have enough income to pay cash for a house, medical bills, and everything else you want, then you don't need to be concerned about credit... so long as nothing happens to your income. For the rest of us, credit is important because our credit rating will affect both our ability to obtain those goods or services as well as the amount we will have to pay for them.

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## 10 Steps For Building Credit

There is no fast lane to good credit. Building credit takes time because building trust in any relationship takes time. Here are the top ten things to do:

**1 Check your credit reports.** First, make sure there are no errors on your reports that might be negatively affecting your credit rating. To find out how to check your credit reports for free, see the "To Find Out More" section below.

**2 Get and keep a job with a regular paycheck** to show a stable income.

**3 Create a spending plan (budget).** Good credit will be unreachable if you spend more than you earn. A spending plan will also help you with the next three steps. To find out how to create a successful spending plan, see the last section below.

**4 Open a checking account.** Use it responsibly; review your statements, balance your checkbook, and be sure to never overdraw the account. If the service is available, have your paycheck directly deposited into your bank account. Otherwise, make consistent deposits yourself. Consider banking with a credit union. Credit unions are often more responsive to the needs of their members.

**5 Pay your bills on time.** If you have utilities or medical bills in your name, make sure you pay them in full and before the due date. Most utility companies offer a no charge auto-pay service, otherwise allow 5 to 7 days for mailed payments. Carefully review and keep your statements.

**6 Open a savings account.** If possible, have a portion of your paycheck automatically deposited to a savings account. Otherwise, make regular deposits yourself. If you are going to be applying for a loan and you know approximately what the monthly payment will be, make sure your monthly deposit is at least that amount.

**7 Apply for a credit card or a small loan.** The goal is to have between two to four accounts.

• **First consider where you bank.** Find out the lender's requirements and only apply for a card if you think you can qualify. If your application is denied, ask the lender why.

• **Consider a department store or gas credit card.** They can be easier to get than a bank-issued card, but be careful of high interest rates and finance charges.

• **As a final option, consider getting a secured card or a co-signer temporarily.** Look into a secured card that has a credit limit based on a deposit you are required to make (for the deposit funds, you can use the savings account you started). A co-signer is someone who is willing to be responsible if you don't make your payments. If you have a relative or friend who is willing to take that risk, make sure they get a copy of your statement each month and tell them you will get a new account solely in your name as soon as you can.

**8 Avoid unnecessary finance charges.** If you get a credit card, use it only for things you need and can afford to pay in full each month. For the first month, however, leave a \$20 balance to make sure that the account is reported to the credit bureaus. If you get a small loan, be careful of the terms (look for no prepayment penalty and for simple interest). Again, use a strategy to minimize your interest charges while you create a positive payment history. If possible, pay most of the balance with the first payment (let's say all but an amount equal to 5 monthly minimum payments), then make the minimum payment for 5 months to pay it off in full.

**9 Limit your requests for credit.** Your credit file lists these requests and it will not be favorable to have more than four of them per year.

**10 Stay put and be patient** for a while. Show stability in your place of residence and stick with this credit-building program for four to six months before you re-check your credit score or re-apply for credit.

For **19 ways to raise your credit score**, see the "To Find Out More" section below.

## To Rebuild Credit

All of the steps in the previous section also apply to rebuilding credit. Review each one thoroughly. In the first step – checking your credit reports – there will be more work to do. If your reports contain any negative information, you will have to address it. If you find any errors, dispute them with the credit bureaus. For information on how to do that, see the last section of this publication. If a debt is accurate, take care of it (pay it). Finally, if you're having trouble doing that on your own, consider consulting a reputable non-profit credit counseling service.

## Credit Repair Scams



Be cautious of "credit repair" offers. The Federal Trade Commission has stated, "the truth is, they can't deliver... Everything a Credit Repair Clinic can do for you legally, you can do for yourself at little or no cost."

(Source: [www.ftc.gov/bcp/online/pubs/credit/repair.htm](http://www.ftc.gov/bcp/online/pubs/credit/repair.htm))

## Credit Myths

- ✗ You can have it now even if you don't have the money now.  
**Fact:** That line of thinking leads to overspending or living beyond your means which will lead to major debt trouble.
- ✗ You're fine if you just pay the minimum payment. **Fact:** Minimum payments are designed to keep you in debt 15 to 20 years on average.
- ✗ Paying late is no big deal. **Fact:** If you are one day late with your payment, you will be charged a late fee. A \$30 late fee on a \$1000 balance is equivalent to an APR of 360%.
- ✗ You can't have too much credit. **Fact:** Too many credit lines will bring your credit score down.
- ✗ Checking your credit reports is not critical. **Fact:** 4 out of 5 credit reports contain errors. Credit report errors can keep you from getting a mortgage, apartment, credit card, or even a job.

## To Find Out More



- For a free annual copy of your credit reports visit [www.annualcreditreport.com](http://www.annualcreditreport.com) or call 1-877-322-8228.
- Read the following articles available at our website [www.knowdebt.org/education.php](http://www.knowdebt.org/education.php):

- How To Check Your Credit Reports
- The Spending Plan

- Raising Your Credit Scores
- How To Dispute Errors On Your Credit Reports