

Need help building credit

Are you interested in home financing but you have little or no credit? Chances are mortgage lenders will turn you away and tell you that you need to build credit first. Credit is one of the most important parts of the U.S. financial system. Having a strong credit score is essential if you intend to make a large purchase such as a home. Your score also factors into the price you pay for financing, such as the interest rate and down payment, and is used as part of the decision-making process when lenders evaluate your loan file for approval.

So what do you need to know about building your credit the smart way?

There are many resources on the internet that provide guidance on establishing credit. Most lenders use a scoring formula called FICO, and this company offers a website with guidance for consumers. It's a good place to start:

<http://scoreinfo.org/FICO-Scores/Establishing-Your-Score.aspx>

How to Establish GOOD Credit

(parts of text are from www.creditscore.net, a personal finance blog on all things credit and debt-related)

One of the most important aspects of your financial life is your credit. Your credit is essentially your financial reputation. It is a record of how you handle your money obligations. Because it is fairly simple to check your credit report, or your credit score, there are a number of people who might be interested in your credit. This includes lenders, of course, but also insurers, cell phone providers, landlords and even employers.

You should realize that your financial name is being established almost from the beginning. The first loan you get, whether it is a credit card or a car loan that your parents co-sign, is the beginning of your credit history. How you handle the payments will be recorded in your credit report, and used to determine your credit score. If you start off on the wrong financial foot with your bills, you will find it difficult later to get certain jobs, buy a house, or even be approved for a cell phone plan.

How Your Credit Rating is Calculated

Most people equate their credit with the credit score. A credit score is a numerical representation of your credit history. You have three main credit reports, made up of information reported to the three major credit bureaus (Experian, Equifax and TransUnion). Information from these credit reports is taken and assigned number values. These values are then plugged into a formula. The most popular credit score model used is the FICO score, although there are other scoring models that might be used for different purposes.

For the most part, your credit score is comprised of five main factors:

- 1. Payment history:** 35% of your credit score is based on how you handle your payments. If you pay on time, your behavior positively impacts your score. If you are late, the information is recorded in your credit report, and then used in the calculation of your credit score. Realize that non-credit payment problems can impact your credit score as well. If you are late with utilities, or with the rent, you might be reported to the credit bureaus, and that payment information will become part of your credit profile and included as a negative item in calculating your credit score.
- 2. Amount of credit used:** Another 30% of your credit score has to do with how much of your available credit is being used. If you are close to the maximum on your credit cards, it will drag down your score. The way you pay down installment debt, such as mortgages and car loans, will also factor in to how your credit is viewed.

3. **Age of credit:** Next, the age of your credit accounts for 15% of your credit score. There are two parts to the length of your credit history. Your oldest account is considered, including how long it has been open. This provides an idea of how long you have been using credit. The longer you have used credit, the better it is for your credit score. The other part is the average age of all of your accounts. The higher the age, the better your credit score, and the longer you have accounts in good standing, the more it will help your credit.
4. **Types of accounts:** All of the accounts you have opened are included in your credit report. The credit scoring formula takes into account whether or not you have a diversity of accounts. Having revolving accounts, like credit cards, mixed with installment accounts, like car loans, can show that you handle different types of credit responsibly. Also realize that where you get your account matters as well. A payday loan is not considered as favorably in your score as a mortgage. A credit card from a department store is more negative than a credit card from a major bank issuer. The types of accounts you have account for 10% of your FICO score.
5. **New credit and inquiries:** The final 10% of your credit score is based on the credit inquiries made on your behalf. When you look at your own credit, or if someone looks at your credit without you asking them to, it doesn't factor into your credit score. However, if you apply for new credit, it will be included in calculations for your credit score. Your score can be lowered if you apply for too many credit accounts at once.

Because your credit rating is so important, it is vital that you work to begin establishing good credit as early as possible. This means that you have to use credit in a responsible manner.

Getting Started

If you are just starting out, it is vital that you start out right. You will need to open some sort of credit account if you are to build good credit. One of the easiest ways to begin establishing credit is to get a credit card. If you are under 21, you will need to prove that you have a job that will allow you to handle making payments on the credit card account, or you will need a co-signer. However, it is important to be careful when you use a credit card. It can be the fastest and easiest way to establish a good credit rating, but it can also be a fast way to overwhelming debt. When you open a credit card account, follow these rules to help you establish good credit while avoiding the pitfalls of debt:

- **Keep to a budget:** Remember that a credit card is a loan. So you should make a budget and stick to it. Don't spend money you don't already have. Before you make a purchase with your credit card, make sure you have money in your checking account to cover the cost, and make sure that the purchase fits within your budget.
- **Track your spending:** Keep track of purchases you make. After you buy something, record the transaction in a ledger, or in personal finance software. When you track your spending, you can reduce the chances that your credit card purchases will get out of control.
- **Only buy one or two small items each month:** As part of your budget, choose one or two items to buy with your credit card each month. Make sure these are small enough purchases that they fit into your budget.
- **Pay off most of your balance each month:** Next, write a check each month to cover the purchases you made. If you stick with your budget, there should be plenty of money in your checking account to pay off most of your credit card balance. You should leave a small balance at least once each 6 month period so that the credit formula reads the activity on your account. This way, you will be able to build good credit, without paying lots of interest on your credit cards.

When you show that you can make regular payments on a credit card, this reflects well on you financially. Using your credit card as part of your budget can be an ideal way to build credit – as long as you avoid buying things you can't truly afford.

Your next step in establishing good credit should be to get some type of installment loan. Once you have begun building a positive credit history with a responsibly used credit card, it is easier to get an Installment loan, such as a car loan or a personal loan from the bank. Try to borrow as little as possible for your installment loan, and make sure you can afford the payments.

Try to keep the loan to 24 or 36 months, and make your payments on time. This will help you build diversity in your credit accounts, and prove that you can handle different types of loans.

As you work to establish good credit, you should follow the basic rules of good personal finances. This means that you need to avoid spending more money than you earn, as well as set money aside in savings to serve as a safety net in times of financial difficulty. If you establish good financial habits, you will not need to turn to credit cards and loans to help you get out of tight spaces. That way, you can maintain your good credit over your lifetime.

Re-establishing Good Credit After Making Mistakes

While it's always best to start out with good credit habits that will lead to good credit, sometimes we make mistakes. If you have made a mistake with your credit, you can re-establish your financial reputation. However, it takes planning and effort to improve your credit once it is labeled as "poor." Some of the things you can do to help re-establish yourself as a responsible credit user include:

- **Start making payments on time:** From this point forward, make on-time payments on all of your bills and credit loans. Reduce your debt: Set up a debt repayment plan to reduce what you owe. As you pay down your debt, your credit will improve.
- **Pay off negative credit accounts first:** Get rid of payday loan and car title loan accounts as quickly as possible. They'll remain on your credit report, but as you eventually get better accounts, they won't be as important in figuring your credit score.
- **Think twice about closing major credit accounts:** It can be tempting to close credit card accounts, but you should think twice. If you have a major credit card, and you have had it for a long time, closing the account can actually hurt your credit score. Instead, consider leaving the account open. It will positively help your credit utilization, since it will appear that you have plenty of available credit. Plus, it will provide you with a longer credit history.
- **Consider a secured credit card:** If you have been through a bankruptcy, and you no longer have any credit accounts, you might not qualify for an unsecured credit card. If you can get a secured credit card, it can help you re-establish your credit. You will have to put a certain amount of money in an account to secure the card. Make sure that the credit card issuer will report regular payments to the credit bureaus. Then, after a few months of being responsible, you can ask to have the secured credit card converted to an unsecured credit card – something that will help your credit.

How long it takes to re-establish your credit rating will depend on how poor your credit is, and the severity of the problem. If you have a foreclosure, it can take up to two or three years – or more – to re-establish credit that is good enough to buy a home. It can take five to seven years after a bankruptcy to re-establish your credit. For less severe problems, you can see substantial improvements in less than a year.

Check your Credit Regularly!

If you want to maintain your good credit, you should check your credit report regularly for mistakes. Because your credit rating is based on the information in your credit report, inaccuracies can lead to a lower credit score. Check your report regularly so that you can catch mistakes and have them fixed. This is also a good way to catch identity fraud early, and avoid having your credit ruined by identity theft. You are entitled to a free credit report from each of the three major credit bureaus once every 12 months. Visit www.annualcreditreport.com to access your free credit report copies. Otherwise, unless you have been denied credit, you will have to pay to see your credit report.

Go to <http://www.annualcreditreport.com> for a free copy of your credit report from each credit bureau once a year. This free report does not give you a score, just the actual report. You would have to actually pay for the score. Also, for your information, the scores you would buy at this site are not FICO scores, which are typically used by lenders, but instead they are Vantage scores. Therefore, the numbers will not match up if you compare them to what a lender pulls on you. For more information on FICO vs. Vantage scores:

<http://mcmf.wordpress.com/2011/05/02/fico-vs-vantagescore/>

I Can't Get Credit Because I Don't Have Credit!

You will need a good mix of types of credit on your report. A good place to start, however, is with a credit card, which is called a revolving account. The catch, though is that when you are trying to establish credit, it can be hard to find lenders that will approve you for accounts! The following resources can help you find those companies that are willing to help customers establish or reestablish credit. You might have to start with a secured account, in which you have to deposit money on the account and draw against it. You might also try smaller local lenders such as credit unions. Just make sure that the account you get reports to all 3 credit bureaus so that you are building credit with all 3 bureaus. This is VERY important!

**secured: www.publicbankcard.com (reports to national bureaus, no credit check)

unsecured: www.orchardbank.com (they require 1 open tradeline with 6 month history, provided by HSBC, reports to all 3 bureaus, \$59 annual fee)

Also, there are 2 web sites that help you search for cards in the marketplace based on your credit situation:

www.mycreditcardfinder.com and www.creditcards.com

Look at terms first and then apply to a select couple of cards so as not to rack up a huge stack of inquiries.

Bottom Line

Good credit doesn't just happen. You have to work to establish a good financial reputation with the help of credit. Create a plan that can help you use credit without being overwhelmed by debt. Incorporate credit into your budget so that you can use it to make purchases – and pay them off without having to pay a great deal in interest charges. If you plan your finances, live within your means, and use credit wisely, you will find that you have a good credit rating – and that will help you get the best deals on future purchases, and even help you get the career that you want.

** Allen Tate is not endorsing any credit cards or their associated banks. We are simply providing possible sources for customers to obtain new credit who might be having a difficult time building or rebuilding credit. The referenced institutions may change their product availability from time to time, so customers should read information carefully.