Team Pinto's Ultimate Credit Score Guide

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Team Pinto's Ultimate Guide to Your Credit Score

And How To Fix a Bad One

Do you really need to create a whole white paper devoted to the subject of credit scores, credit reports and how (and how not) to improve them all (as well as how not to mess them up)? **Based on what we see and hear every day, absolutely.** Considering these things are such an important part of your financial life - actually, make that life in general - the amount of misinformation and misunderstandings out there is amazing - and disheartening.

Simple fact. **Bad credit = stress, frustration, more money needed to buy things like houses.**

And *because 90% of the things that you read and hear about credit scores are completely false* that really needs to change. **Most people think that they understand credit scores when in truth, less than 10% of these people have any idea what they're talking about.** That's not actually a scientific fact, but based on our experience it is close. So, via this white paper, we are going to turn you into part of that well-educated minority.

Ready? Let's get started.

Here's what we will be covering:

Why Should You Care About Your Credit Score?

Why should you care about your credit score and therefore keep reading this white paper at all?

Because, like it or not, **your credit score can vastly improve - or seriously damage - your quality of life.** It can help you get a mortgage for that home you want to buy one day or keep you renting for decades. *It can also determine how much that house is going to cost you if you are approved for a loan.*

Here's a quick example

The house you want to buy is **$250,000**

You get approved for a mortgage (yay!)

But because your credit score is less than ideal it'll cost you an extra **$31,000+** in interest

That's a lot of cash.

So even if your credit score is 'OK' it's really not. *Not unless you like overpaying for everything.*

What Is A Credit Report?

A credit report is a **detailed report that contains information about your credit history**.

Some things that are included are **the status your credit accounts, loans, bankruptcies, late payments, credit inquiries, public records, and even some personal information** such as your address, date of birth and where you are registered to vote.

This information is collected by the two major credit reporting agencies - *Equifax Canada and TransUnion Canada*- and each one compiles it into their own single credit report.

Although each reporting agency has their own credit report, the information that each of them collects is very similar.

The credit reporting agencies then **sell this information to businesses like banks, credit card companies, insurance companies, and even landlords and employers**, where it is used to determine your creditworthiness.

Here's a quick analogy

Think of your credit report like your old school report, except it's not.

Your school report? It's a record that shows what classes you have taken and what marks you received in each of them. And then your teacher makes a comment or two about the kind of student you are.

But unlike a school report, **your credit report does not explicitly state whether you are a “good” or “bad” credit risk.** It simply presents the historical information that has been gathered and then lets lenders figure the rest out for themselves.

What Is A Credit Score?

Your credit score, on the other hand, is a **numerical assessment that quantifies the risk that you present as a credit.** It is used by lenders to answer the question “How much risk am I taking by lending money to this person?”

Your credit score is calculated by taking information from one of your credit reports and running it through a mathematical algorithm created by two men called Earl Isaac and Bill Fair in the US back in the Fifties. They founded a company called Fair Isaac Corporation and started this whole credit score thing off. **It's their 'fault' your credit score exists in the first place.** All credit agencies in the world make use of a version of this algorithm.

The algorithm uses the information found on your credit report to generate a number between that represents the risk you present as a credit.

The higher your score, the less risk you present to lenders, and **therefore the more likely you are to qualify for credit - and a lower interest rates on any form of credit line.**

While there are a variety of different credit scores that are used by lenders, the basic scoring weights and factors used are the same.

How Your Credit Score Is Calculated

Your credit score is calculated using the following 5 criteria:

Credit Score Calculation 1. Payment History (35%)

The most important factor in determining your credit score is your **payment history.** This measure reflects the number of times that you have paid your credit bills on time.

The more on-time payments you make, the higher your score will be.

It is important to note that bills such as rent and utilities do not contribute to your payment history. **Credit agencies do not consider these types of bills to be credit accounts**, so they do not include them when calculating your score.

These items can, however, *have a negative impact on your score if you don't pay them and they are turned over to a collections agency.*

Not only is your payment history the most heavily weighted metric, but it is also the most volatile. **Miss just a couple payments and you could drop over 100 points off your score** (ouch!) That big of a drop will limit your ability to qualify for any sort of credit card or loan.

2. Amounts Owed (30%)

The second largest factor in determining your credit score is **the amount of the debts you owe.** This metric is broken down into a few subcategories.

Total Amount Owed: This is the total amount of debt that you owe on all of your credit cards, loans, etc. Generally speaking, the less debt you have the better your score will be.

Having zero debt, however, does not guarantee a good credit score. More on that later.

Total Amount Owed by Account: This is a measure of how much debt you have on each of your accounts. Creditors commonly refer to this as your credit utilization, which is expressed as a percentage of your credit limit that you are using.

For example, if you have a $1,000 limit on a credit card and have a balance of $500, then your utilization for that card would be ($500/$1000=) 50%.

Generally speaking, the lower your utilization, the higher your credit score will be.

The exception to this rule is having 0% utilization. 0% utilization indicates you don't use credit, which is riskier than using some credit. So 0% credit utilization could have a negative effect on your credit score.

It's also important to note that your credit utilization is not tracked historically. Only your current utilization counts, so don't worry about what it was last month/year/etc.

How Many Accounts Have Balances: Carrying a balance on a large number of your credit lines indicates that you may be a high-risk borrower and can lower your credit score.

Original Amount of Installment Loans vs. Current Balances: Paying down installment loans (mortgages, car payments, etc.) is a good sign that you are able to manage and repay debt. **Like credit card payments, you always want to make your installment debt payments on time and in full.**

3. Length of Credit History (15%)

Length of credit history is a measure of the amount of time that you have been using credit. This metric takes into account the age of your oldest account, the age of your newest account, and the average age of all of your accounts. *In general, a longer credit history will lead to a higher credit score.*

All trade lines, whether opened or closed, will contribute to your average age of accounts until they fall off of your credit report (at the 7-10 year mark)

Don't close old accounts just for convenience. More on this later.

4. New Credit (10%)

New credit is a measure of your credit seeking activity. *By applying for and opening a lot of new accounts in a short period of time you are indicating that you might be a risky borrower,* which will cause your credit score to fall.

5. Types of Credit Used (10%)

This factor looks at your **mix of credit cards, retail accounts, installment loans, finance company accounts, and mortgage loans.** You ideally want to have a healthy balance of credit card debt and installment loans to show that you know how to manage both types of debt.

How Do You Check Your Credit Score?

You can ask for a free copy of your credit file by mail. There are two national credit bureaus in Canada: Equifax Canada and TransUnion Canada. You should check with both bureaus.

Complete details on how to order credit reports are available online. Basically, you have to send in photocopies of two pieces of identification, along with some basic background information. The reports will come back in two to three weeks.

The "free-report-by-mail" links are not prominently displayed — the credit bureaus are anxious to sell you instant access to your report and credit score online.

For TransUnion, the instructions to get a free credit report by mail are available here. For Equifax, the instructions are here.

If you can't wait for a free report by mail, you can always get an instant credit report online. TransUnion charges $14.95. Equifax's rate is $15.50.

To get your all-important credit score, you'll have to spend a bit more. Both Equifax and TransUnion offer consumers real-time online access to their credit score (your credit report is also included). Equifax charges $23.95, while TransUnion's fee is $22.90. There is no free service to access your credit score.

How To Build And Maintain A Good Credit Score

Ok, so you now know **what a credit score is, how it is calculated, and how to check it.**

But how do you make sure that you are able to build and maintain a good score?

Here are 4 tips that will help:

1. Understand How Your Credit Score Works

Your credit is **one of the most valuable assets that you own** and ruining it will have lasting effects on your financial well-being. For this reason, it is important that you take the time to learn how it works.

This will help you make informed credit decisions and take the necessary steps to maintain a good credit score.

By taking the time to read this overview **you are already taking the first step.** It may help to review it a couple times to make sure that you didn't miss anything.

In addition to understanding how your score works, *it is also important to check it regularly to avoid issues such as account errors or fraud.*

2. Always Make Your Payments on Time

Put simply, **missing credit payments have the potential to wreak havoc on your credit score.** Having *just one or two missed payments can drop your score by more than 100 points* and make it very difficult for you to qualify for any sort of loan.

You absolutely have to make all of your payments on time and in full if you want to maintain a good credit score.

If you're worried about missing payments we highly suggest you take advantage of "auto pay" features offered by banks/credit card companies etc. as often as you can.

3. Build a Solid Credit History

The more of a credit history you have, **the more evidence there is that you are a responsible borrower.** This will help to boost your score and *insulate it against minor ups and downs* that can be caused by things like new credit inquiries or accounts.

The best way to build a solid credit history **is to continually stick to the first two tips that you just read.** If you continue to monitor your credit score and make your payments on time you will be able to build a solid credit history.

It is also a good idea to keep your older credit accounts open and in good standing.

Although it can be tempting to close credit accounts that you no longer use, keeping them open helps to build your credit history and *thus boost your credit score.*

As a general rule, we would suggest that you **never close any credit accounts that do not have an annual fee.**

4. Keep Your Credit Card Balances Low

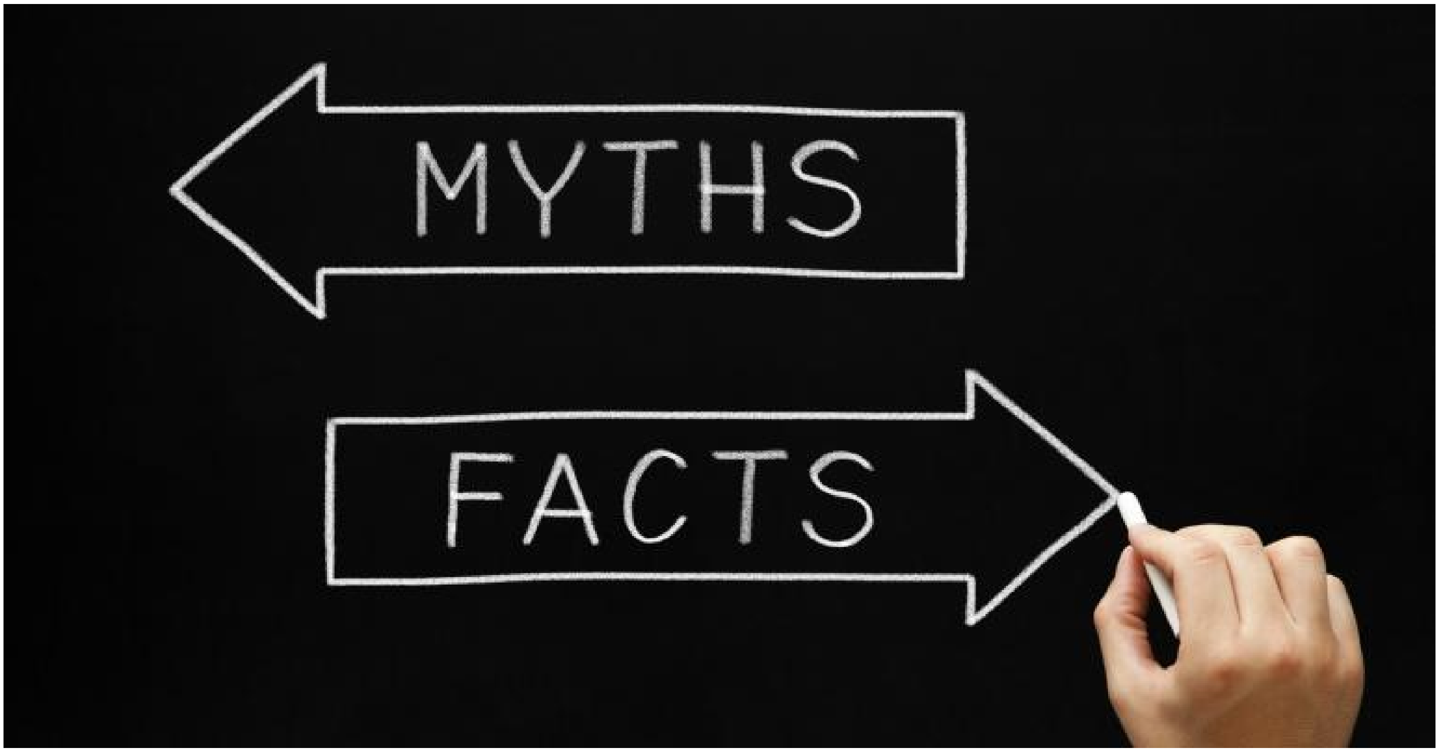
The last tip for maintaining a good credit score is to **keep your credit card balances low.** Generally speaking, the higher your credit card balance is, the lower your credit score will be.

To prevent this from occurring it is best to **keep your credit utilization below 30% at all times** (That’s $300 on a credit card with a $1,000 credit limit). Going above 30% could cause your score to fall*, even if you are paying your balance in full every month.*

By understanding how your score works, always making your payments on time, building a solid credit history, and keeping your balances low, **you will be able to build - and maintain - a good credit score**. And life will just be better.

Now let’s tackle a few common credit myths.

Common Credit Score Myths



Credit Score Myth #1: Paying cash for everything will help your credit score

The thinking behind this myth is pretty simple. **Paying cash = no missed/late payments = good credit score.** The assumption being that "good" credit is the default, *which is completely false.*

Paying cash (or using debit cards, gift cards, cheques, etc.) for everything **prevents you from building a credit history**, which means you will likely have a very low credit score or won't actually have one at all.

Here's an idea. Get a credit card with a low limit. Use 30% of that limit to do your weekly shop. Take the cash you would have used to pay for the outing usually and use it to pay the charge off your credit card in full. *You'll be meeting all those credit score building requirements we've been talking about and you still won't be in debt.* A win-win situation if there ever was one.

Credit Score Myth #2: Having too many credit cards will hurt your credit score

This is an age-old question about credit cards. **What is the right number of cards to have?**

We hate the answer "it depends", but in this case, it seems appropriate.

Allow us to elaborate.

As we discussed above, **30% of your credit score is based on the amount of debt that you owe with respect to your total available credit (called "credit utilization").**

In an ideal world, you would always *keep your utilization below 30%* (i.e. $300 on a credit limit of $1,000).

Below 20% would be even better, but 30% is a good benchmark.

But if 30% is the minimum, what is the maximum? Will having a bunch of credit cards hurt your score?

Nope, in fact **that will likely help your credit score by reducing your credit card utilization and increasing your number of on-time payments.**

Generally speaking, there is no such thing as having "too much credit". *As long as you are making all of your payments on time, extra available credit will actually help your score.*

Credit Score Myth #3: Checking your credit will hurt your score

In the world of credit scores, **there are two types of credit checks, "hard enquiries" and "soft enquiries".**

A "hard enquiry" occurs **when your credit report is pulled as a result of some sort of application for credit** (credit cards, mortgages, car loans, etc.). Each hard enquiry dings your credit score by roughly 2-5 points, depending on a variety of other factors.

A "soft enquiry" occurs when you pull your own credit report or when a company pulls your report for a non-credit use such as a background check. *Unlike a hard inquiry, a soft inquiry has no effect on your credit score.*

So how do you go about checking your score (and not hurting it)?

Other than requesting copies of your actual credit report (as outlined earlier) you can sign up for Credit Karma. It is a free to use (ad-supported) website that will help you track your credit score progress. There are other sites out there, but this is the only free site we have found to be useful or credible.

Credit Score Myth #4: You should close accounts after paying them off

This myth is related to the number of credit score myths, but the number of questions we have heard about it on a regular basis justify a separate entry.

Generally speaking, you should never close a credit account unless you have a reason to.

Common reasons include *avoiding an annual fee, transferring your credit to another card, etc.* Never close an account just for convenience.

But why?

Closing accounts reduces your total available credit, causing your credit utilization to increase and therefore your credit score to fall.

Closing accounts also prevents you from **building additional credit history, which makes up 15% of your score.**

This myth persists because **people think that closing an account will remove it from their credit report,** therefore hiding any bad history from future lenders.

Just like bad relationships, **you can’t just delete all of the evidence of a bad credit account and forget that it ever happened.** Only time heals. The account will remain on your credit report for up to 10 years, at which point it will fade away. *Just like those bad memories of your terrible ex.*

The best course of action is to **keep the account open and in good standing,** allowing you to build credit history and maintain a good credit utilization ratio.

Credit Myth #5: You need to carry a balance to build your credit score

We have never really understood this myth. We're supposed to believe that **by not making payments on time we are somehow improving a metric that measures my likelihood of making my payments on time?**

The most common justification for this practice is the belief that *carrying a balance on your credit card is the only way to build credit history,* which makes up 15% of your score. After all, having no balance means you have no credit history right?

This is completely false.

You are building credit history regardless of whether or not you carry a balance on your card. Carrying a balance will only leave you with tons of late fees and interest charges.

Credit Myth #6: Paying all of your debts will instantly fix your credit score.

This is like believing that starting a diet will instantly make you skinny.

The truth is that **your credit report reflects your history of using credit, not just a snapshot of your current situation**. Even after being paid off, it can take as many as 7-10 years for a debt to fall off of your credit report.

So if you are looking for a quick fix for your credit score, this is not it.

Credit Myth #7: You only have one credit score.

This myth is perpetuated by all of the advertisements that encourage you to "check your credit score" as if there is only one score that is used for everyone.

We wish it were that simple.

The truth is that there are dozens of credit scoring models that are used to predict your likelihood of default. **Each of them is a little different and at times can produce dramatically different scores.** While we would love to discuss each of them with you (actually, that sounds awful), we'll save us all the time and cut to the chase.

The most widely used credit score are those issued directly from the two credit reporting agencies. Other credit scoring models are often referred to as "FAKO" scores. While these scores can be really useful for getting a basic idea of where you stand, *the genuine scores are the ones that really count.*

Credit Myth #8: Once a credit score is bad it can't be fixed.

We have found that this is more of an excuse than a myth. **People with bad credit tend to bring this up when they are confronted with the idea of repairing their credit score.**

In reality, they are simply trying to justify their laziness.

While there are certainly no “quick fixes” for a credit score, *it can be rebuilt with a little bit of patience and discipline.* The key is to start making your payments on time and building a history of responsible credit use.

Credit Myth #9: Income/education/net worth can affect a credit score

Your income, education, net worth, etc. **have absolutely zero effect on your credit score.**

Your credit score is a reflection of your ability to pay your bills on time, not your current financial standing. *It cannot be improved simply by earning or saving a lot of money.*

Credit Myth #10: Credit reports are only used for financial purposes

In addition to being used in credit decisions, **credit reports can be used by current and potential employers to aid in employment decisions.** While they cannot see your actual credit score, employers are able to view a modified version of your credit report that includes information about loans and credit cards listed in your credit report.

This practice is especially common in industries such as banking or finance, where employees are responsible for dealing with a client’s personal finances.

This is just another reason why your credit score is such a crucial component of your overall financial well-being.

How To Improve Your Credit Score

Don’t be discouraged if you happen to find yourself with a credit score that is lower than you would like it to be. **Your credit score is never permanent and it can be improved with a little bit of patience and the right advice.**

With that said, let’s take a look some proactive steps that you can take to improve your credit score.

1. Check for Errors on Your Credit Report

The first step to improving your credit score *is to check for any errors on your credit report.* Errors are relatively common and can have serious effects on your credit score if they are not addressed quickly.

Common errors to look for are duplicate account listings, inaccurate personal information, or identity theft.

Look over the entire report for any inaccuracies and **send any disputes to the credit agencies in writing.** They are required to investigate any information that you dispute and *will make corrections where needed.*

2. Try to Pay Your Bills On Time

The next step is to do everything you can to start paying your credit bills on time. This is pretty obvious, as your payment history is the biggest factor in calculating your credit score, but it is crucial to improving your score.

Continuing to miss payments will not only prevent you from improving your score, but it could also cause it to fall even further. We definitely do not want that.

Start by targeting the accounts that are in collections first, as these are the most harmful to your score. Make sure to document all of your correspondence with your debtors and to request a “paid in full” letter when your debt has been paid. *Things can get pretty dicey when you are disputing debts* so you’ll want to make sure to cover all of the bases.

Phone conversations should be avoided if possible.

Then work your way up to more recent debts, *focusing on the ones that are close to your credit limits first.*

3. Reduce Your Spending

This step requires you to be brutally honest with yourself.

Sometimes things like medical emergencies, unexpected job loss, unforeseen car/home repairs, etc. occur suddenly and cause financial distress. We get that.

But most times bad credit is caused simply by spending beyond your means.

Regardless of what caused your credit to be damaged, **you are going to have to make sacrifices to fix it.**

That $30 a month wine club you just joined? **Cancel it.**

That $3 a day latte habit? **Stop it now and make your coffee at home.**

These actually may seem like small expenses, but they add up and they add up quickly. Make a budget. Stick to it. Hate budgeting? Try the 50/20/30 Rule. It helps you build a budget by usin**g three spending categories:** 50% of your income should go to living expenses and essentials. This includes your rent, utilities, and things like groceries and transportation for work. **30% of your income should be used for flexible spending** (yeah, maybe you can have those lattes after all) and **20% should go to savings.**

4. Don’t Close Old Accounts

While it is tempting to close credit cards after paying them off, **it is best to keep them open if you want to improve your credit score.**

When you close a credit account it reduces your total available credit, *which causes your credit utilization to rise and your credit score to fall.* Closing old accounts can also reduce your length of credit history (15% of your score), especially if one of them happens to be your oldest line of credit.

Closing old accounts does not make them go away. Items such as delinquencies or bankruptcy can remain on your credit report for years, regardless of whether or not the accounts have been closed.

5. Opening New Accounts

How you approach this step depends on your credit history.

If your credit score is low because you have little to no credit history then you should *try to open a new credit card account.* This will help to establish some credit history and start improving your credit score.

You should only apply for a card that you are likely to be approved for so it might be a good idea to start with some of the more basic credit cards offered in the market. *Opting to go for a secured card might also be a good option.*

If you already have an extensive credit history then **you should avoid opening new credit card accounts if at all possible.** Applying for cards could cause your score to fall even farther and you will likely be denied for them anyway.

Finally, remember to be patient! Improving your credit score won’t happen overnight but it can be done with discipline and persistent effort. **And the one thing we can promise? The effort will be worth it.**

Why are we telling you all this about your credit score? Because it's so important when it comes time to purchase a Waterloo Region home and to get a mortgage to do so. As one of the region's leading real estate teams we help people do that all the time, but based on our experience the mortgage process was the one thing that many buyers feared the most. Our solution? Help our clients find the right one for them at the beginning of the process. So one half of Team Pinto - Angelica Pinto - became a mortgage agent.

Ready to buy your first home? There are many things to consider. It will be my pleasure to take you through the steps in securing the best possible mortgage with both best rates and terms!

Mortgage Refinancing - Get out of a high rate mortgage or use your home equity to pay off high interest loans and credit cards or for other important needs.

Mortgage Renewals - At the time of renewal of your mortgage, you are eligible to negotiate based on the current market opportunities. Make sure to take advantage!

Find out what you can afford! Let me review your personal situation to determine how much home you can currently afford and let's see what implications this will have on your monthly spending.

Angelica Pinto Mortgage Agent

Markets Served: Kitchener, Waterloo, Cambridge, Guelph, Hamilton, GTA, Niagara Falls and Toronto