WEEK ONE

Lower Your Cost of Credit

This week, you can

- Understand what a FICO score is and why it's important
- Correct errors in your credit report
- Learn how to boost your score for cheaper financing

We are defined by many numbers. There's the powerful Social Security number that can give thieves access to your identity. Are you a member of a union? Do you have a bank account? Do you have investment accounts? All these entities have assigned you a number. I know adults who can tell you their SAT scores even though the test was taken decades ago. But of all the numbers that identify you, your FICO score needs to be near the top of your list.

Your FICO score (developed by the Fair Isaac Corporation) is a snapshot of your credit history and a measure of your creditworthiness, at least in the eyes of most lending institutions. In lieu of telling a mortgage bank, car dealer, or furniture salesperson what a reliable person you are, potential creditors simply check your FICO. In other words, how trustworthy have you shown yourself with money up to now? Do you pay your bills on time or are you riddled with late fees? Have you ever defaulted on a loan? How much money do you owe? Did you forget to return some library books? (Library fines that are turned over for collection can lower your score by as much as 100 points!) In this day of instant communication, when you default in one area, all the other aspects of your financial life know about it. And down goes your FICO score.

FICO scores are important because those with the best scores get the best deals, by far, on the credit market. I'd rather you don't borrow at all (aside from carrying a mortgage), but if you must, at least borrow cheaply. Having a sterling FICO store and comparison shopping for credit are key.

CHECKING YOUR CREDIT SCORE

Three credit bureaus—TransUnion, Experian, and Equifax—collect data on you. (Contact information for each appears in the "Resources" section, page 251.) Each bureau arrives at a score based on different criteria. Every year you are entitled to one free report from each of the bureaus; to see your report, log on to www.annualcreditreport.com. I spread my requests out so that I can check my credit health throughout the year.

The report (a snapshot of your bill-paying dependability) is free. However, if you want to learn your score, you have to pay the entity a nominal fee. It's worth it.

Many lenders will use only one of these credit bureaus; others will contact all three and take the middle score. Just to complicate matters, Equifax is the only credit bureau that provides you with your actual FICO score. At TransUnion and Experian, the score you purchase is similar to the FICO but based on slightly different criteria. If you want to see your score based on all three reports, go to www.myfico.com.

HANDLING CREDIT REPORT ERRORS

Once you have your credit report, check it for errors. Be sure all the accounts listed are ones that you opened and maintain. This report is one of the tools you can use to monitor for identity fraud. Do you see any errors? If so, do the following:

- Immediately draft a letter to the credit bureau stating what you believe to be the error.
- Explain why you feel this is a mistake, and attach copies of any material that verifies your story.
- Include a copy of your credit report with the item in question either circled in red or highlighted.
- Request an immediate change in the status of your credit report.
- Send your letter via certified mail with a return receipt request.

The investigation usually takes thirty to ninety business days to be resolved.

You will also want to draft a letter to the creditor who is supplying what you consider to be incorrect information. Your letter to them can be brief. By enclosing copies of the material you are sending to the credit bureau, you are documenting your case. Request that the provider copy you on all correspondence to the credit bureau. Be sure and certify this letter as well. Keep copies of all correspondence in the "Pending" folder you made when you created your new file system. Remember to check your "Pending" file once a week to be sure nothing important falls between the cracks. If you want to save these reports, you have two choices. If everything is in order, you won't need a hard copy. Create a file on your computer that says Credit Reports. I would keep it in the Financial section of your files. Every year let the new report from each agency replace the old one. If you want to keep hard copies instead, shred the old report.

INTERPRETING YOUR SCORE

FICO scores range from 300 to 850. The higher the number, the better. Most people will find themselves in the 600s and 700s. (The average score in the United States is 723.) Anything over 700 makes you a prime borrower, likely to get the best deals in town on any loan. A score below 600, and you'll likely need to pay top dollar to compensate lenders for the risk they will see themselves taking by lending you their money.

BOOSTING YOUR SCORE

If a new car or a home is in your financial sights, you want to have the best FICO possible. It's worth it to dedicate some time and energy to boosting the numbers. It could save you thousands down the line, especially if you are contemplating taking on a new mortgage or home equity line of credit. You can increase your FICO score in four ways, as follows:

1. The number-one way to boost your score is to pay your bills on time. This is why one of the first items we addressed in this book was bill paying. You must have a system. If you aren't generating enough money to stay current, return to April for long- and short-term ideas to help you generate additional funds. If you are unable to make ends meet, don't hesitate to contact your creditors to see what special arrangements they can make for you. You may not be able to avoid a ding on your credit score, but at least you won't completely obliterate your credit history.
2. If you are new to credit or perhaps recovering from a bankruptcy, foreclosure, or lien, build your good credit slowly. Don't go out and open multiple accounts in a short period of time. This may have an adverse affect on your score. Always take time to demonstrate how responsible you are. Remember too that your *debt ratios*—the amount of debt you carry as a percentage of your total income and as a percentage of your total credit availability—are key factors in determining your FICO. You don't want to max out your credit cards! Nor do you want to have too many.
3. Remember to consider all your credit cards, including department store cards. If you have some that have been inactive, don't close them all at once as a way to raise your FICO. You might just lower it. (Yes, this is tricky business!) Why? You will have potentially adversely affected your debt ratio by lowering your overall credit availability, thus raising the ratio of the amount of debt you carry to that availability limit. By the way, have you noted that department store credit cards usually come with exorbitant interest rates? You'll fare better if you use a Visa, MasterCard, Discover, or American Express card. Of course, if you intend to pay your department store purchase in full when you receive the bill, by all means use the store's card, especially if the store offers a discount or special service

(such as free shipping) on purchases made with the card.

4. Don't continuously open low-interest-rate accounts in an effort to keep your debt "in motion." Paying off your balance is the goal. If you already have a fist full of cards, you are in trouble. You don't need any additional fuel on the credit fire. As you pay off your cards (start with the highest interest-bearing cards rather than the highest amount), literally cut up those cards. You don't want a zero balance to tempt you to get back on the treadmill of debt. On the other hand, if you have only one or two credit cards and feel that opening a third to secure a few months of interest-free or low-interest payments would help reduce your overall debt, take advantage. Remember that over time, with regular payments and a reduced balance, your FICO will climb.

Never pay a fee to a debt consolidation company to raise your score. They can't do it! Only sound fiscal practices on your part can affect your score.

TAKING A BREAK

Take some time this week to find out your current FICO score and consider ways to improve the number. Don't forget to check your report for any errors. And remember that the easiest ways to establish good credit are to consistently pay your bills on time and keep your balances under control. Next week, you'll continue your credit investigation.