

# Credit Reports

## Credit Reports

1. A credit report is a record of how you pay the money you owe to your creditors. It includes the names of companies that have lent you money, your current account balances, and the timeliness of your payments.
2. Your credit history usually contains four types of information.
  - Your identification
  - Your credit history, such as who gave you credit and when, how much you paid, how often, and if you paid on time.
  - Anything on public record like bankruptcy filings, tax liens, and court actions.
  - A list of parties who have recently inquired about your credit report.

## Credit Reports

3. Creditors, insurance companies, some government agencies, landlords, employers and you are allowed to see your credit report.
4. You should review your credit report every year to check for inaccuracies. The FACT Act permits you to receive a free report from each of the three major credit bureaus every year.

## Obtaining a Copy of Your Credit Report

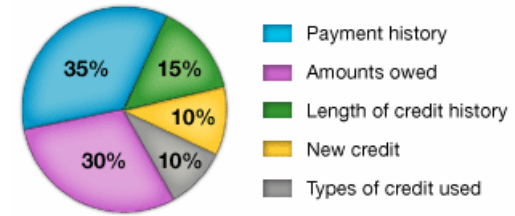
- ❑ You can get a free copies of your credit report by going to:  
[www.AnnualCreditReport.com](http://www.AnnualCreditReport.com)
- ❑ The three major credit bureaus: Experian, Equifax and TransUnion—contact information for all three available on the above webpage.
- ❑ Your free credit reports will not contain a credit score—this is something you'll have to pay for.
- ❑ [Sample credit report](#)

## How are Credit Scores Calculated

- ❑ Credit scores are designed to measure the risk of default by taking into account various factors in a person's financial history.
- ❑ The exact formulas for calculating credit scores are closely guarded secrets, and differ from credit agency to credit agency.

## How are Credit Scores Calculated

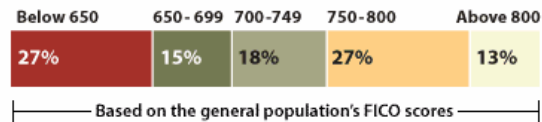
- ❑ Fair Isaac has disclosed the following components and the approximate weighted contribution of each:



- ❑ Still hard to know exactly where credit score comes from.

## Interpreting Your Credit Score

- ❑ Credit scores usually range from around 300 to 850.



## Interpreting Your Credit Score

- ❑ When you go to get a loan, lenders often will take the middle of the three credit scores reported by the three credit bureaus.
- ❑ There is no one way to interpret credit scores, but here is a rough guideline.

Above 730	Excellent credit
700 - 729	Good credit
670 - 699	Lender will take a closer look at your file
585 - 669	Higher risk; you will not be eligible for the best rates and products. Credit products may not be available.
Below 585	Credit options will be limited or not available. Lender will need to consider other information in your application.

## Why Have a Good Credit Score

- ❑ Credit scores are used by potential lenders to determine the likelihood that you will default.
- ❑ Credit scores can determine whether and how much lenders are willing to lend you.

## Why Have a Good Credit Score

- ❑ The higher your FICO scores the less you can expect to pay for your loan. For example, on a *\$216,000 30-year, fixed-rate mortgage*:

Credit Score	Interest Rate	Monthly Payment
760 - 850	5.86%	\$1,276
700 - 759	6.09%	\$1,307
680 - 699	6.26%	\$1,332
660 - 679	6.48%	\$1,362
640 - 659	6.91%	\$1,423
620 - 639	7.45%	\$1,503

## How to Build a Good Credit History

- ❑ Get all three of your credit reports and make sure each is accurate.
- ❑ If your report includes late or missed payments more than 7 years old, ask to have them removed—same for bankruptcies more than 10 years old.
- ❑ Pay your bills on time.
- ❑ Keep balances low on credit cards.
- ❑ Limit your debt and the number of debt accounts.
- ❑ Apply for and open new credit lines only as needed.
  - Older credit lines are better than new ones, but don't stick with old credit lines if they have unfavorable terms.

## How to Build a Good Credit History

- ❑ Limit unnecessary credit inquiries.
  - **Hard inquiries:** negatively impact your credit score (mortgages, car loans, some banks when you open a checking account—actions you take to open a line of credit.)
  - **Soft inquiries:** do not impact your credit score (pre-approval for mortgage, credit card companies, your own inquiries, employer inquiries)
  - Not always clear if an inquiry will be hard or soft, so if in doubt ask.
  - The number of inquiries and the time since the last inquiry are important.

## Sources of Errors

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- ❑ Report may have incorrect personal information.
- ❑ Report may have missing information.
- ❑ Report may have someone else's information.
- ❑ Incorrect information from creditors.

## Reporting Problems

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- ❑ The Basic Steps
  - Contact all of the credit bureaus where the mistake appears.
  - Contact creditors directly if there is a mistake regarding your credit—the credit bureau should be able to tell you how.
  - Ensure that the error is fixed—the credit bureau should get back to you within 30-45 days.
- ❑ Tips
  - Adjust your expectations—fixing an error is not going to be hassle-free.
  - Act business-like (no screaming)
  - Keep copious records of every phone conversation, getting the names and telephone extensions of people with whom you speak.
  - Follow up phone conversations with a certified letter.
  - Ask for written confirmation of verbal promises to correct mistakes.

## Saving More, Spending Less



## Dealing with Debt

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- ❑ Experts usually differentiate between “good debt” and “bad debt”
  - Good debt: borrowing to finance a long-term investment like education and real estate.
  - Bad debt: debt incurred for consumption (cars, by the way, count as consumption).
- ❑ Many people get into serious problems with bad debt by buying things they can't afford.
- ❑ Every year 1.5 million American households (1 in 80) file personal bankruptcy.
- ❑ My hope is that none of you will ever get into serious problems with debt.
- ❑ If you do, seek reliable advice about reducing your debt.

## Budgeting and Saving

- ❑ Figure out where your money is going.
- ❑ Figure out how much you'd like to save each month.
- ❑ Figure out where you can cut your spending.
- ❑ Recognize the dividends to saving—the miracle of compound interest!

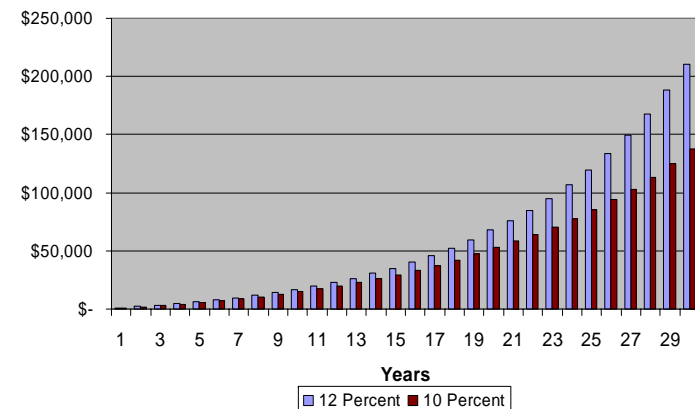
## The Miracle of Compound Interest

- ❑ More generally, suppose you have  $M$  dollars and you invest it at an annual interest rate of  $r$ .
  - At the end of 1 year you will have  $M(1+r)$ .
  - At the end of 2 years, you will have  $M(1+r)(1+r)=M(1+r)^2$
  - At the end of 3 years, you will have  $M(1+r)^2(1+r)=M(1+r)^3$
  - At the end of  $N$  years, you will have  $M(1+r)^N$
- ❑ You earn interest not only on the original investment  $M$ , but also on the interest that you accrue.
- ❑ This is the meaning of “compounding”
- ❑ The implication is that your money will grow **exponentially**.

## Illustration

- ❑ Stop buying a latte each morning for \$3.50. If you buy the latte 20 mornings a month, then this will save you \$70/month or \$840/year.
- ❑ Suppose that at the beginning of each year, you invest that \$840 at an annual interest rate of 10%.
  - At the end of 1 year:  $\$840(1+.10)=\$924$ .
  - At the end of 2 years:  $(\$924+\$840)(1+.10)=\$1,940$
  - At the end of 5 years: \$5,641
  - At the end of 10 years: \$14,726
  - At the end of 20 years: \$52,922
  - At the end of 30 years: \$137,266
  - Under your mattress:  $840*30=\$25,200$ .

## The Importance of the Interest Rate



## Taking Advantage of Compound Interest

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- ❑ Save early and often.
  - The earlier you start, the longer your money has to grow.
  - Over time, investing small amounts of money can add up to astonishing amounts.
- ❑ Small differences in return matter a lot, especially over the long haul.
- ❑ **Time and patience** are the key to taking advantage of compound interest—and they are also the key to investing.

## Some Strategies for Spending Less

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- ❑ Adjust your attitude
  - Think hard about what matters to you in life.
  - Impressing others with expensive clothes and cars isn't everything.
  - You don't inherently deserve to have nice things.
- ❑ Sweat the small stuff because it adds up.

## Other Tips

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- ❑ Shelter
  - Move to a lower-cost rental
  - Get a roommate.
  - Buy rather than rent if your time horizon is long (more than 5-6 years)
- ❑ Take advantage of retirement savings plans

## Other Tips

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- ❑ Transportation
  - Don't buy a car unless you NEED one.
  - Research the cars you buy & think about long-term costs
    - ❑ Consumerreports.com
    - ❑ Edmunds.com
    - ❑ Intellichoice.com
  - Don't lease, and try to only borrow if the interest on your car loan is less than the interest rate on your investments—car loans are “bad debt”.
  - If you borrow, don't just think about monthly payments.
  - Consider buying a used car.
  - Consider trading in your expensive car for a cheaper one.
  - Don't trade in your car just because it's two years old.

## Other Tips

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### ❑ Insurance

- Consider raising your deductibles
  - ❑ Insurance is to protect you against economic disaster.
  - ❑ If you make a lot of claims because you have a lower deductible, then your insurance premiums will start increasing.
- Don't buy insurance for anything that won't be a financial catastrophe if you have to pay for it out of your own pocket.
- Shop around for insurance—we'll talk more about this later.

## Other Tips

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### ❑ Eating out

- Avoid beverages, especially alcohol.
- Eat vegetarian
- Limit how much you do it.

### ❑ Eating at home

- Join a wholesale superstore
- Eat vegetarian

## Other Tips

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- ❑ Avoid the Mall—just don't go there.
- ❑ Go to the library for books and videos.
- ❑ Automatic deductions are your friend.

## Homework

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- ❑ Get a copy of your credit report from one of the credit bureaus.
  - In a paragraph, briefly describe your credit report.
  - Are there items on your credit report that surprised you?
  - Are there any mistakes on your report?
  - What is the nature of the mistake?
  - How could you fix the mistake
  - If you do not have a credit record or if your credit record is very short, briefly describe how you intend to start building a credit record.