IN THIS CHAPTER

- Handling credit problems
- Dealing with the issues surrounding fairness in credit
- Rebuilding your credit after a crisis such as a foreclosure or bankruptcy
- Safeguarding your credit and your identity
- Discovering how to manage your credit
- Keeping your credit solid in every stage of life

Chapter 1

Introducing Credit Repair, Credit Scores, and Your Life on Credit

Credit plays a larger role in life than ever, and its influence will only expand in the years to come. The good life, happiness, and credit are inextricably linked. It's not that more material things make you happier, but bad credit exacts a price from your life, your hopes, and your dreams, as well as your relationships with others. Think of it as your credit/life connection. Whether it is hard or easy, fair or not, you must learn to successfully manage your credit and, by extension, your personal finances if you are to lead a successful and satisfying life in the United States.

Financial products, credit foremost among them, have become much more complex and powerful, while the price for having a bad credit report or no credit at all has never been steeper. Your *credit report* is a financial snapshot of your life in financial terms. For example, a divorce can wreak havoc in your life, and that instability can show up as missed payments or even a bankruptcy on your credit report as well. When you use credit, the information usually gets reported to a data center known as a *credit bureau.* This information ends up on your credit report for at least the next seven years. The good, the bad, and the ugly are all there for anyone you do business with to see and for FICO, VantageScore, and other lesser-known scoring elves to summarize in a three-digit number known as your *credit score.*

A bad credit report can keep you from finding a job, getting the promotions you deserve at work, being approved for an affordable loan, getting insurance (or paying the lowest price for it), securing an apartment or house, and more.

This chapter is all about getting you started in repairing, rebuilding, or even just starting your credit so you can get that job, promotion, loan, home, and insurance to protect it. I cover the basics and the fine points. It's really simple. But if you don't understand credit, you can't fix it, so I discuss how credit works, how to apply that knowledge to get what you want, how to deal with the effects of life's inevitable setbacks on your credit, and how to recover from those setbacks as quickly as possible. Other chapters build on this information, helping to make your credit the best it can be and keep it that way. Why? Because life isn't always fair, but you still need to repair the damage and carry on without being taken advantage of by unscrupulous financial companies or wasting precious years recovering from credit problems that you can avoid or minimize by using the advice in this book.

Repairing Bad Credit

After you've had a rough patch and fallen behind on your payments, you may think that you can never recover. Between the cost of interest and maybe even collection actions, the situation can be overwhelming. But I assure you that you can reverse the cycle. You can not only reestablish good credit but also keep good credit and enjoy its benefits for the rest of your life. Forever is a long time, but if you follow my advice, you can banish the credit blues permanently! It's not magic, and it won't cost you another dime. By realistically assessing your situation, seeing yourself as others see you, knowing where you stand, using free help if you need it, setting goals, planning your spending and savings, and using credit as part of your overall plan, you can quickly rebuild your credit.

Settling debts

You hear the ads all the time: "Settle your debt for pennies on the dollar!" "You have a right to pay less than you owe!" Debt settlement is an often misunderstood option that may work for you, but only if you handle it properly. Many companies that offer debt settlement services help themselves a lot more than they help you. You can avoid huge fees and potential credit damage if you reach a settlement agreement with your lender on your own for free using the information in this book or if you use your own attorney.

REMEMBER

You are personally responsible for the actions of the debt settlement company you hire, and your credit will be ruined in what is a protracted and adversarial settlement process. Chapter 6 gives you the information you need to decide whether debt settlement is for you and outlines your best options.

Resetting your goals

Just as you did when you first started establishing credit, I want you to revisit your goals from time to time. When your life changes, your goals should reflect your new reality. Goals that once seemed within easy reach may move from short term to long term. Others may change as you mature. Buying that red sports car may not be as important to you now as it was in your 20s. Take the time to reset your sights, as I explain in Chapter 2.

Begin by envisioning your life as you'd like it to be over the short, medium, and long term. Next, create a spending plan (or update your plan if you already have one) so that you know your current financial strengths and weaknesses. Then begin to see how long it will take to fund your goals and determine when using credit may be appropriate. Chapter 18 goes into detail about how to create and maintain a spending plan and how to use credit wisely as a part of that plan.

To ensure that your credit is up to the task of supporting your goals for the future, check your credit reports and dispute any inaccuracies or out-of-date information. To rebuild your credit reports, you need to start with an accurate credit history, not one riddled with errors that may hold you back. After you check your reports, look for opportunities to review them for free as often as you can. Part 4 tells you everything you need to know about credit reporting.

Rebuilding your credit by using it

The best way to rebuild your credit is to exercise it! Using your goals and spending plan as a guide, start making those payments as agreed, on time and for the correct amounts. Every month you do so, you build better credit while your older, bad credit either counts for less or drops off your credit reports altogether.

TIP

Consider opening a *secured credit card* (backed by a bank account deposit) or a *passbook/savings account loan* to add a revolving and installment account to fatten your credit history and boost your score. You can find the details in Chapter 10.

Using a cosigner or becoming an authorized user

I normally don't recommend that you, personally, ever cosign for a loan, but in this case, someone else is doing the cosigning for you! Enlisting a cosigner is a way to get access to credit so that you can begin to rebuild your credit history with the credit bureaus. But you need to keep in mind a few important rules:

- You have to make all the payments on time.
- If you can't make a payment when it's due, you have to tell the cosigner in advance so that the cosigner can make the payment and protect his or her credit. You can pay your pal back later.
- You can't get mad at the cosigner for not being understanding or more helpful while you owe him or her money. Your cosigner is doing you a huge favor at great personal credit risk!

Another way to rebuild your credit is to become an authorized user on someone else's credit card. After you're added to the other person's account, his or her good credit history flows onto your credit record as a positive account and payment stream, beefing up your record and credit score. The person needs to have good credit, though, or his or her bad credit may negatively affect yours. I suggest that you decline getting your own card for the account so that only the other person's charges appear on the account. That way, if he or she has a bad memory (as I do), you're spared monthly calls asking whether this or that charge is yours. Although you won't have access to new credit, your credit score gets a boost.

Finding sources of free help

You can do a lot of things on your own, but sometimes having a pro on your side to give you tips helps. You can find that help in three main places, and it ranges from inexpensive to free. Nonprofit credit counselors, pro bono lawyers, and HUD-approved counseling agencies offer priceless free insight, assistance, and advice. The trick is to know to ask for it.

Nonprofit credit counselors work with you to set goals, develop a spending plan, and assess your ability to repay your debts. They can set up a repayment plan in concert with your lenders to lower your payments and interest rates and get positive information back on your credit reports faster than you could on your own. They're funded by creditors but work for you, and I recommend the good ones highly. Discover where to find the good ones in Chapter 4.

Lawyers sometime offer free or pro bono help if you can't afford to pay. Chapter 4 includes a list of resources to help you find one in your area.

A mortgage is a different and sometimes dangerous type of loan. The rules for handling a delinquent mortgage are different from those for regular consumer debts, and the penalty for a mistake can be the loss of your home. So, I strongly recommend that if you have a mortgage problem, you get professional, HUD-certified help. You can find an agency at the HUD website (`www.hud.gov`).

WARNING

Watch out for bad help. In a nutshell, if someone approaches you and offers to help for a fee, don't do it. The free resources work well. The costly ones too often are just ways to separate you from your money while you're under stress.

Dealing with collectors

Sometimes, you have to take the call. You know it's a debt collector, but you don't know what to say, do, or offer. Chapter 5 spells out how to take control of the collection process. Collectors must follow certain rules, and if you know the rules, you'll feel more confident in dealing with a stressful situation. The Fair Debt Collection Practices Act (FDCPA) regulates what collectors can and can't do. In general, this law protects you from abuse and threats. For example, a collector can't threaten an action that it can't or doesn't intend to take, can't make harassing calls, and can't use abusive language. When you know your rights and insist on being treated fairly, you can negotiate a payment schedule that fits your budget. If you need help coming up with a workable plan, you can always ask a credit counselor for assistance.

Chapter 5 offers solutions that work. From how to handle calls and threatening letters to how to craft a repayment proposal, I walk you through how to keep a small collection annoyance from becoming a major and upsetting life event.

Weathering a Major Crisis

Some credit problems are worse than others. In Chapter 7, I cover four of the big ones: mortgages, medical debt, student loans, and auto repossessions.

Mortgage meltdowns

In my experience, a mortgage crisis is among the most upsetting, expensive, and damaging to your credit and relationships. Your home is your castle. When you are at risk of losing it, you likely feel as though your very existence is under attack. Thinking matters through and coming up with the best solution for you and your family may be difficult. In this section, I preview the major options to help guide you along the best path. Check out Chapter 7 for more mortgage information.

Mortgages are different from other types of debts and credit because of a number of factors, including the size of the debt, the importance the lender attaches to a debt secured by a home, and the fact that the debt is probably packaged in a security that's been resold many times and is subject to inflexible collection rules. Mortgage delinquency can have a significant and long-lasting negative effect on your credit score. For example, being just 30 days late on a mortgage payment can cost you 100+ points on your credit score and take three years to recover from. The upshot is that if you're in danger of falling behind on your mortgage payments or you're already behind, you're better off seeking professional help.

Opting for help

In a mortgage crisis, the sooner you get help, the better. The reason is simple: The stakes are high and the help is free.

WARNING

Most people who have a mortgage payment due on the first of the month know that they have until the 15th to pay it. But do you? If you miss that payment on the 15th, you're 45 days late. Mortgages are paid in arrears, so the bill is already 30 days old when you get it. Miss the due date and the 15-day grace period goes away until you catch up. By the 15th of the next month, you're 15 days away from a foreclosure action. Fast, isn't it? So, I suggest that you don't delay in contacting a HUD-approved counseling agency. These agencies are often housed in credit counseling agencies, so they can address all your debt issues at once.

Doing it on your own

You may insist on working out your mortgage problems on your own. The process is tricky and long, but it can be done. Chapter 7 goes into details on the steps and time frames for action. In addition to acting quickly, you need to keep excellent notes about who you speak with, when you talk, and what is said. You're dealing with a bureaucracy, and bureaucracies love to forget that they ever heard from you and send you all over the place to avoid responsibility for helping. So good notes are essential. Chapter 7 lists key terms and things to ask for so you can know what you're talking about.

REMEMBER

Just because a bank doesn't want to take your home doesn't mean that it won't.

As in any debt resolution process, you need to do your homework before you call your mortgage servicer. Know what you really need in terms of help to take care of your missed payments, and know what you can offer. You may be able to make additional payments over a six-month period to catch up. Or you may need to ask for a reduced payment amount for a certain amount of time. Whatever you need, you have to be specific. Chapter 7 helps you understand the major options, but they change frequently, so you may have to rely on your mortgage servicer (the bureaucrat) to advise you.

If you can't work out a compromise, there are ways to leave your home that result in less credit damage. Among them are

- **Deed-in-lieu of foreclosure:** You give the house back, saving the bank foreclosure expenses.
- **Short sale:** You get the bank to agree to let you try to sell the house for less than the mortgage value.
- **Friendly foreclosure:** You cooperate with the bank and leave the house in good shape on a timely basis.

Chapter 7 goes into more detail about these options.

Strategic mortgage default

Strategic mortgage default isn't an option that anyone likes. However, a number of people consider walking away from their homes as an alternative to trying to work matters out. Based on how much you owe, you think that you are unlikely to get back the money you're putting into monthly mortgage payments. Why waste thousands in overpayments? Following that reasoning, some people mail the keys to the bank and walk away from their homes.

Credit damage from a strategic default is significant and lasts a long time. You can expect to have really bad credit for seven years and to see a credit score drop of 140 to 160 points. (See Chapter 14 for more on credit scoring.) Plus, Fannie Mae, the government agency that guarantees most mortgages, won't guarantee a new loan for you for the next seven years, which means that to buy another home in the next seven years, you'll pay more for a new mortgage and you'll need expensive mortgage insurance.

Medical debt

Being ill is bad enough. Dealing with medical debt can sometimes seem insurmountable. There are special rules in both credit reporting and credit scoring that can help set your mind at ease. Knowing the rules from Chapter 7 may help lower your blood pressure. I also help you deal with medical insurance issues with a list of your options and resources.

Student loans

Chapter 7 covers how to establish a credit history using student loans. When your payments begin, I cover how to avoid a default and, if that's not possible, where to get help. Did you know you may be able to get your student loans forgiven? I cover the rules and more in Chapters 7 and 23.

Car loans

Missing a payment or two may not be a big deal for a credit card, but it can be a disaster for a car loan. Knowing what counts can help you avoid a repossession along with the expenses and damage to your credit that goes along with it. I cover your options to cure a default, scams to avoid, and what happens if your car is repossessed.

Understanding Fairness in Credit

For most Americans, credit is as American as apple pie. But for some, especially minorities, the poor, and immigrants, credit can appear mysterious, unfair, and part of a system designed to ensure an expensive failure on their part. Chapter 19 tackles these issues and more head on. It recognizes the previously discriminatory history of race in credit while offering a solid understanding of why that's no longer the case. It details how credit reporting, credit scoring, and credit legislation have reset the relationship between lending and minorities. It also debunks credit myths with credit facts and offers tips to make you successful, whether you're applying for a loan or need to access help if you get in trouble.

When it's time to take control of your credit, this chapter is your ticket to success. Just follow the ten steps detailed in Chapter 19, and you'll have great credit and a high score to match.

Filing Bankruptcy

There are times in life when you just can't cope. For some people, this is also true in credit matters. If you're unable to come to terms with the aftermath of being overextended, bankruptcy may enable you to hit the reset button and start over again. But there is no free lunch.

While you pay a price in terms of future credit, bankruptcy for the right reasons and in the right circumstances may be your best bet. This section gives you a quick look at an often misunderstood and misused tool so that you can decide whether the cure for your debts is worth the damage to your credit. Chapter 8 has more information on the bankruptcy process, what it means to you, and what your alternatives are.

If you do opt for bankruptcy, you need to pass a means test to see which type you can file for. Chapter 7 bankruptcy gets rid of some of your debts but not others. If you don't qualify for a Chapter 7, Chapter 13 bankruptcy requires you to pay what you can afford to your creditors over a five-year period. In a nutshell, if you earn too much money, you have to pay your bills in a Chapter 13.

Even worse, from my point of view, is that filing for bankruptcy may not solve your problem. If you're in debt trouble because you spend more than you make — or, to put it another way, because your expenses exceed your income — then bankruptcy won't change the situation. Before long, you may be back in debt, but without the option of refiling. After filing for bankruptcy, you face a waiting period before you can file again. This period can range from two to eight years, depending on the type of bankruptcy you file and the type you want to file next.

REMEMBER

In today's tight credit market, expect a long recovery time from a bankruptcy. Recent FICO research indicates that a Chapter 7 filing can lower a good credit score by up to 240 points and that it takes seven to ten years for the score to recover to its original level. Ouch! That's a long stay in the bad credit hotel. Be sure it's worth it!

Protecting Your Credit and Your Identity

Your credit history is increasingly used for more than just determining the interest rate on your credit card. It affects your ability to compete for a job or a promotion; get affordable insurance; qualify for professional licenses, military service, and security clearances; and even find a decent place to live. At the same time, data breaches have exposed the Social Security numbers and passwords of millions of people to identity thieves. These thieves can use stolen identities to establish credit, drain your bank account, access medical treatment, and file false tax returns in your name without your knowledge and then leave you to straighten out the mess.

Getting familiar with credit laws

Over the last several years, Congress has passed new laws to give consumers more protections. Knowing about and taking advantage of these safeguards can help you keep your credit safe. If your identity is stolen, knowing your rights is essential to a quick resolution. Among the laws I discuss in Chapter 20 are the

- **Dodd–Frank Wall Street Reform and Consumer Protection Act,** which created a consumer watchdog agency and allows consumers free access to their credit scores (sometimes at a price).
- **CARD Act,** which restricts lenders from raising rates on existing balances and more.
- **FACT Act,** which gives you access to free credit reports and identity theft protection.
- **Fair Debt Collection Practices Act (FDCPA),** which spells out your rights and the rules that debt collectors must follow.

Receiving free reports and filing disputes

As Chapter 13 explains in more detail, the Fair Credit Reporting Act (FCRA) as amended by the FACT Act entitles you to a free copy of your credit report annually from each of the three major credit bureaus: Equifax, Experian, and TransUnion. They are currently offering free reports as frequently as weekly. I strongly recommend that you get these reports on a regular basis and check them for errors. In addition, your state may require the bureaus to give you more copies — sometimes many more! In addition, you're entitled to extra free reports, free credit scores, if you've been turned down for credit, didn't get the top rate offered, or had an adverse action (like a reduction in credit limit) on a credit card. All these situations are opportunities to check and clean up your credit reports for free.

Signing up for credit monitoring

Every time I turn around, someone is offering to monitor our credit. Do you need this service, and are you willing to pay for it? This question has become more complex due to extensive data breaches and rising identity theft numbers. Chapter 15 gets into the details of credit monitoring and identity theft protection.

REMEMBER

If you have a credit card, you may already have basic fraud-monitoring in place. Most cards monitor spending patterns to sniff out fraud and identity theft before they cost the card issuer a fortune.

Setting alarms, alerts, and freezes

If you're worried about others accessing your credit data, you have the right to limit access to only those you approve. Chapter 15 covers how to limit access, along with the pluses and minuses of doing so. Among your options, you can

- Set up alerts with your creditors to spot new activity on your account.
- Place an alert on your credit file so that lenders use more caution before approving any changes.
- Place an active-duty alert on your files if you're a member of the military.
- Freeze access to your account so that no new creditors can access your information without your express permission (except if you owe the government money).

Identifying identity theft

Identity theft isn't going away. The number of cases reported is small in relation to the huge amount of identity information that hackers collect every time you hear of a database compromise. Your identity may be in jeopardy for years to come as thieves warehouse stolen data and piece together a profile of your identity using artificial intelligence.

Simple vigilance can help you stop identity theft in its early stages before serious damage is done. Follow these tips from Chapter 21:

- Protect your information at home. Often identity theft is low-tech and committed by people whom you invite into your home.
- Shred financial documents that contain account and Social Security numbers.
- Use electronic bill paying to avoid bill theft from your mailbox.
- Check your credit report frequently to look for unfamiliar credit lines. If you see accounts you don't recognize, take the actions I suggest in Chapter 21.

If you become an identity theft victim, you need to take fast, effective steps as soon as you find out you've been victimized. Chapter 9 walks you through what you need to do and whom you need to contact. It also helps you reestablish your credit afterward.

Maintaining Good Credit Throughout Life

Your credit report presents a financial snapshot of your life . . . so far. As your life changes, your credit report changes, too. If your life is filled with positives like a steady job, a good income, controlled expenses, and maybe even a partner, then your credit report should reflect that stability. If, however, you have a reversal of fortune with a job loss, income interruption, illness, or divorce, expect your credit to reflect the stress of your life.

Establishing credit for the first time

Getting credit doesn't need to be scary. You have easy ways to establish credit for the first time — or the second time around as a newly single person. Knowing what to do and what to avoid makes this process simple and foolproof. Chapter 10 covers the essentials of getting your credit up and running. Using simple techniques like borrowing your own money and using retail store cards and authorized user accounts, you can establish good credit in no time. Your credit score can be figured on a history of just a month or two, and then you're on your way. If you're concerned that credit is unfair, Chapter 19 gives you the facts and tips you're looking for to be sure you'll be successful applying for and using credit.

TIP

Here are a few ways to build credit for the first time:

- Open a secured credit card with a bank that reports monthly to all three bureaus.
- Open a savings account at a bank that reports loans to all three credit bureaus. Then take out a loan using the account as security and make monthly payments on time.
- Have a relative add you as an authorized user on his or her credit card. Your relative's history for that account will flow onto your credit report.

Making credit changes at life's stages

As you move through life, you'll find new needs for credit and encounter new challenges in keeping your credit strong especially when life gets bumpy. Chapters 11 and 12 help you negotiate life's often turbulent credit waters without capsizing your boat. Credit plays a strong role in every aspect of life, including getting a job, buying a home or renting an apartment, purchasing a car, insuring your home and car, getting married or divorced, paying medical bills, planning for retirement and end-of-life expenses, and more!

Many people know that because a prospective employer may check your credit in the hiring process, having good credit while job hunting is important. But how can you keep your credit in good shape when you've been laid off and don't have enough income to handle all your bills? Chapter 12 tells you how. It also gives you practical tips for safeguarding your credit before, during, and after a divorce.

Avoiding pitfalls

Whether you're new to credit or you're a credit veteran, you need to be careful of counterproductive actions. Some examples of things I advise you to avoid if at all possible are payday lenders, refund-anticipation loans, check cashers, and credit repair companies.

WARNING

You won't go blind from using a *payday lender* once for an emergency, but the very concept of this type of high-interest loan is flawed. If you have no savings, you're living paycheck to paycheck, and an emergency expense comes up, does getting a payday loan make sense? You have to pay back a short-term (two weeks or so) loan on your next payday. But all that money is already committed, so how can you pay it back? Chances are you'll need more than one loan and end up owing lots of money in fees and interest charges.

Refund-anticipation loans are another potentially counterproductive borrowing product. These loans accelerate an e-filed tax refund by a very short period for a very large fee when calculated as an annual percentage rate (APR). Plus, if your refund is held up or reduced, you owe more money on the loan than you expected.

Check cashers perform a valid but expensive function for people with no bank accounts who need to cash checks. I suggest that you get a bank account so you have a place to begin saving and stop paying for unnecessary check cashing.

Credit repair companies have a horrid reputation. Legislation called the Credit Repair Organizations Act has tried to limit the damage caused by fraudulent actions that some companies advise to rig the credit-reporting system. If you're thinking of credit repair companies, think again.

Debt settlers can put you into an adversarial process in which you can get caught in the middle of a financial and legal tug-of-war with financial giants that have whole departments of professional collectors and lawyers with potentially devastating consequences. I cover them in Chapter 4.

Managing Credit in Today's Unforgiving Economy

The concept of credit is easy to understand: You receive something *now* in return for your believable promise to pay for it *later.* Mortgages, student loans, credit cards, auto loans, and other types of credit all fit this definition.

Some people think that credit is a way to increase their income. It's not, although credit can help you *manage* your income. Others see credit as a way to enhance status — I have a platinum card and you don't! "Elite" credit cards are just ways to wrap additional products, features, and corporate profits into the same credit instrument.

Credit enables you to conveniently spend money that you've already earned or saved or to spend money today that you'll earn tomorrow. But spending tomorrow's money, today, gets people in more trouble than they ever dreamed of — trouble that can cost them huge interest payments and fees and shut them out of future opportunities. For those with a combination of poor credit management and bad luck, the trouble can take the form of collections and lawsuits. But not for you! Managing your finances is easy if you know the rules of the game, do some basic and painless planning, and know where you stand.

Planning for success

Behind every successful person or venture is a plan. Whether it's detailed or general, a plan for your money and your credit is one of the basic criteria for success. Why? Because others have a plan for your money, and if you don't have one, their plan will win.

Your financial plan begins with envisioning your future as you'd like it to be. Do you desire a home, an education, vacations, a family? The basis of your plan consists of your personal dreams and vision expressed as goals. Long- and short-term goals form a firm base on which to build a plan, and they give you the incentive to fund your plan with savings and targeted spending. Counting up all your income and making decisions on how much to spend and how much to put toward your goals comes next. Called a *budget* or *spending plan,* this tool becomes your road map to financial success. Chapter 18 provides step-by-step instructions for setting up your goals and plan.

After deciding on your goals and setting up your spending plan, you want to consider how credit can help. Using credit cards for convenience and auto and home loans for big-ticket items helps accomplish your goals. Each has different criteria to access to the best, lowest-priced products. The criteria you bring to the table are found in your credit report and credit score.

Reviewing your credit report

Your credit is increasingly used to predict your future value as a customer, employee, and insurance risk. Why? Because if you have bad credit, you're more likely to file insurance claims and perform less well in your job. Research shows that employees with credit problems are less productive and have more absences than those with good credit. So employers use credit reports during the hiring process to complete their assessments of candidates. In a competitive job market, a bad credit report can make the difference between getting an offer and seeing the employer move on to the next candidate.

Lending decisions used to be based on who you were. A local banker typically would know you personally and could approve or deny your application based on your reputation and his prior experience with you. Today, for better or worse, few borrowers have personal relationships with their lenders. Even if they do, most loans go before a committee that requires more than a personal reference to approve a loan. Using the information in your credit report enables a group of strangers to objectively assess your payback record. Credit reports and scores are objective, fact-based, and not subject to prejudice or discrimination. Lenders like to see evidence of character, capacity, and collateral, known as the three Cs of lending. Your credit reports show your *character* (whether you keep your promises) and help measure your *capacity* (how much credit you've handled before). These two factors can impact the amount of *collateral* you need to secure a loan at a given rate.

WARNING

The information in your credit report is essential to your financial life, but what if your file contains mistakes? Your credit report contains personal information, account information, and public legal records about you. After you know what is in your report, you can take simple steps to delete out-of-date or erroneous information and add positive data that polishes your credit image to get you what you want and need.

Knowing your credit score

Your *credit score* is a numerical analysis of the years of credit data contained in your credit report. The organizations that calculate your credit score use a proven algorithm (formula) that can predict the likelihood of you defaulting on your next loan over the next two years. Your score doesn't take into account characteristics like gender, race, nationality, or marital status. The result is a discrimination- and prejudice-free assessment of you as a credit risk (see Chapter 19). Boiling down the decision-making process to a three-digit score also gives you the convenience of a quick approval or denial of your credit application.

Two main scoring models are in use today: FICO and VantageScore. Both scores range from 300 to 850. Several weighted factors make up your score. By understanding these factors, you can avoid surprises when you apply for that mortgage or other loan.

Chapter 13 gives you detailed definitions of each of these scoring factors and tells you how to boost your score with simple credit management techniques, like keeping your card balances below 30 percent of your limit and using your savings account to secure a low-interest-rate loan. The differences in interest payments over a number of years can run from hundreds of dollars on a credit card to tens of thousands for a mortgage.

TIP

All the information used to determine your credit score is contained in one place: your credit report. Well, three places. You have at least three credit reports, from the credit bureaus Equifax, and Experian, and TransUnion. The result is that you probably have at least three different credit scores! How can you be sure that the information in each of your credit reports is accurate and as positive as possible, leading to the highest possible credit scores? Great credit begins by knowing what's in your report and what's not. Part 4 provides more information about monitoring your credit reports and scores.

Considering credit a renewable resource

Many people are uncomfortable when it comes to math. That discomfort can carry over into credit, which is based on seemingly endless and contradictory numbers. I've helped clients understand credit by relating it to something everyone understands: the environment. Everyone knows that pollution is bad for the environment. Everyone knows that environmental resources can either be overused and diminished or be managed well and renewed. And everyone knows that a balance among all the environment's parts is necessary for the environment to be healthy and sustainable. The same principles apply to credit; I call this credit environment your *credit ecosystem.*

You may find understanding your credit easier if you view it as its own ecosystem. Each credit-scoring component affects the others, and pollution in the form of negative reported data hurts your ecosystem. Like the real-world ecosystem, damage from credit pollution takes time to clean up. If the damage is bad enough, it causes severe systemic damage for years before your credit environment can recover.

You manage your credit environment by limiting your use of credit and monitoring your credit's health by being aware of your credit score and the information flowing into your reports. Doing so keeps everything in harmony, and the resulting balance strengthens your credit ecosystem. Overspending and overusing credit deplete your resources faster than you can replace them, much like overfishing or excessive logging. An ever-increasing accumulation of debt from using more credit than you have income to support strains your credit ecosystem, perhaps to the point of collapse.

Defaulting on payments introduces pollution into your credit report. Like an oil spill, this pollution can't be covered up and hidden; you have to clean it up properly and put safeguards in place to prevent it from happening again. Credit pollution, like its environmental counterpart, has effects beyond your credit report. A polluted credit report can hurt your job prospects, place a strain on your finances in the form of larger payments for insurance and loans, and more.

We call credit used wisely, in accordance with your plan to build a positive credit history and score, *green credit.* Chapter 17 gives you more insight into this way of understanding your credit and managing it like a renewable resource. Green credit is part of a balanced spending and income system that's reflected in your spending plan. By using credit judiciously, you increase the buying power of your present income in a responsible way and replenish the resources you're using so they never run out.