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Advisor Article

**The Importance of Monitoring Your Credit Reports and
Optimizing Your Credit Score**

August 2023

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Most consumers know that a higher credit score is better than a lower one. However, many consumers don't really understand how credit reports and credit scores are used, and the real-life impacts they have. This article will focus on why it is important to regularly review your credit reports and strive to achieve a high credit score.

There are numerous resources available to help you understand how your credit score is calculated and the makeup of your credit reports, several which are cited below in the resources section. Since that information is readily available, this article will instead focus on the real-life effects of your credit score and credit report, and why you should regularly monitor them.

Credit History and Credit Report Definitions

Your credit history consists of information such as: 1) how many credit accounts you've had, both open and closed, 2) what types of credit accounts they are, 3) how much you owe on each account, and 4) your payment history.

Your credit report will include information related to your credit history, along with personal identifying information such as current and previous addresses, date of birth, SSN, employment history, credit account specifics and recent bankruptcies. Note that your credit report will typically NOT include your credit score.

Credit reports are compiled by companies called credit bureaus. Equifax, Experian and TransUnion are the three major credit bureaus in the U.S.. Information in each bureau's credit reports might come from different sources, which can result in subtle differences in their contents. Consumers may access their credits reports by going to <https://www.annualcreditreport.com/index.action>.

Credit Score Definition

A credit score is a number used to assess how likely a person is to repay borrowed money and pay bills, which is calculated based on information gathered from several established credit-reporting agencies. Two companies dominate the credit scoring industry – FICO (Fair Isaac Corporation) and VantageScore. Both of these companies use similar algorithms to calculate credit scores, and a credit score range between 300 and 850.

Credit Score Ranges and Categories

Credit Category	FICO range	VantageScore range
Excellent	800-850	781-850
Very Good	740-799	
Good	670-739	721-780
Fair	580-669	661-720
Poor	300-579	601-660
Very Poor		300-600

Factors that Impact Credit Scores

FICO and VantageScore apply different weights to the multiple factors used in calculating a credit score, but both companies prioritize payment history and credit utilization (i.e. current level of indebtedness) as the primary factors when defining a credit score. Other

factors taken into account include the types of credit used, length of credit history, and recent credit account applications.

Your credit score does not take into account other factors including assets, income level or employment status.

Practical Reasons to Monitor Your Credit Score and Credit Reports

1. Watch for signs of Identify Theft and Credit Fraud.

Due to the frequent occurrence of personal data breaches and theft, this is emerging as a top use of credit reports. It is important to check your reports for any personal identification information that is incorrect, credit applications which you didn't initiate, and activity on credit cards that aren't legitimate, as these are all signs of potential credit fraud and identity theft.

2. Ensure that your payment history and all personal identification information is accurate.

A payment that was mistakenly reported late by a lender can badly damage your credit rating. If an error has occurred, you can dispute it with your lender or directly with the credit reporting agency on whose report the late payment appears and have it corrected. Other inadvertent errors, even simple typographical mistakes, can cause delays or issues when applying for credit, employment or insurance.

3. Define a plan to improve your credit score.

Your credit score is based entirely on the information in your credit report, so reviewing your report to identify where you may be able to reduce debt and to ensure all information is up-to-date and accurate can help boost your credit score.

Financial Impacts of Your Credit Score and Credit Reports

A very good or excellent credit score may help someone save many thousands of dollars over the course of their lifetime. Here are several examples, starting with those that have the most significant effect:

1. Home Loans (mortgages): someone with a FICO score of 790 (Very Good) will likely be eligible for a significantly lower mortgage rate than someone with a score of 660 (Fair). Let's say both people are planning to buy a \$500,000 home, with a 30 year mortgage of 90% of the house's price. At the time, mortgage rates to buyers with excellent credit scores are starting at 5.25%.
 - a. The person with the credit score of 790 will likely be offered a mortgage rate in the range of 5.50%. Over the 30 year life of the mortgage, this homebuyer will pay \$469,846 in interest on the mortgage.
 - b. The person with the credit score of 660 will likely be offered a mortgage rate in the range of 6.50% or higher. At 6.50%, the total interest paid over the 30 year mortgage period is \$574,179.

The person with the lower credit score will pay an extra \$104,333 in interest!

2. Auto loans and other loans: similar to the home loan example above, consumers with higher credit scores will be offered lower interest rates on auto loans, revolving debt (lines of credit), and consumer purchase financing (the deals where you get a

new set of furniture and don't have to start making "low-interest" payments for 90 days). The difference in total interest paid won't be as large as in the home loan example, as these loans are typically smaller in amounts, but they can add up to several thousands of dollars in interest paid over a consumer's lifetime.

3. Apartment rental: in most cases, a landlord can refuse to rent to an applicant that won't authorize background and credit checks. They can also refuse to rent to an applicant with a poor credit history or low credit score. Landlords may require a higher security deposit and/or higher monthly rent for an applicant with a low credit score or poor credit history, as they are a higher risk for failing to pay their rent on time.
4. Insurance: a consumer's credit score is a key element of their insurance score, which is used by insurance companies to assess the likelihood of the insurance policy holder to file a claim. Statistically, policy holders with higher credit scores are less likely to file insurance claims (auto, health, home), and are thus typically offered lower insurance premiums. A person with Very Good credit may save \$200 per year on their auto insurance and \$200 per year on their renter's or homeowner's policy, which adds up to \$20,000 in savings over their adult lifetime (~50 years).
5. Credit cards: a person with a higher credit score will be offered credit cards with lower interest rates, lower fees, and better perks than consumers with low credit scores. In some cases, a person with a very low credit score will only be offered "secured" credit cards, which require an affiliated savings or checking account with assets that can be accessed by the credit card company in case the consumer fails to make their payments.
6. Utility accounts: gas, water, electric and cable/ISP companies will typically review an applicant's credit history before establishing a new account. If the applicant's credit history indicates issues related to paying bills on time (or failing to pay bills), the utility company may require a security deposit or require another person with good credit to agree to pay your bills on your behalf if you can't.

Other Effects of Your Credit Scores and Credit Reports

Maintaining a high credit score and positive credit history can have positive benefits in other areas, including:

1. Employment applications: not all employers use a credit report as a deciding factor for hiring, but in certain industries—banking, real estate, and financial services—your credit report can help your chances of getting a job or license.
2. Adjustments to loan and security deposit terms. A creditor may periodically review a lender's credit history after the loan is established to ensure that the borrower continues to meet the loan's criteria and standards. If you've improved your credit history and score over the course of a rental agreement or loan term, you may be able to refinance the loan at a lower interest rate or get a reduction in rent or security deposit requirement upon renewal of the lease.
3. For credit card holders, an improvement in your credit history may lead to an extension of additional credit. You may notice an increase in your credit card's limit –

this will typically be initiated by a favorable review of your credit history after the card was initially offered.

Suggested Actions

1. Prior to requesting a loan or new credit card, shopping for insurance, or applying for employment or apartment housing, review your credit score and credit report so you understand any potential issues before they arise and can explain them if necessary.
2. Most experts, and the Consumer Financial Protection Bureau, recommend that you check your credit reports at least once per year. You should check more often if you plan to finance a big purchase in the next few months or if you know you are at increased risk of fraud. To check your credit reports, you may request free copies from the three credit bureaus (Experian, Equifax, and TransUnion) via www.annualcreditreport.com. It's very important to make sure all three contain accurate information about your personal identifying information and credit history – if you find errors in any of the reports, follow the instructions provided on the particular bureaus' websites to get the matter resolved, and periodically check to ensure the information is corrected.
3. If your credit score falls in the Fair, Poor or Very Poor ranges, define a plan to boost your score. There are many online resources available to help in this effort; Experian offers guidance at: <https://www.experian.com/blogs/ask-experian/ways-to-improve-credit/>.

Resources

1. <https://www.myfico.com/credit-education/credit-scores>
2. <https://www.investopedia.com/fico-credit-scores-explained-5072985>
3. <https://www.nerdwallet.com/article/finance/credit-score-ranges-and-how-to-improve>
4. <https://www.experian.com/blogs/ask-experian/why-you-should-check-your-credit-report-regularly/>
5. <https://www.insurance.com/insurance-score>

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