

Credit scores: Everything you need to know

Why does a credit score matter? How do you find out your credit score? And how do you increase it? We've got all the details here.

If you thought grades were only for the classroom, think again. Your credit score is like a grownup grade, but it's based on your creditworthiness. And just like grades, having a better credit score will get you ahead in life.

Whether you need to score a home mortgage, buy a car, qualify for a credit card, refinance student loans or rent an apartment, it's all based on your credit score. If you aren't familiar with credit scores and how they impact nearly every facet of your financial life, here's a primer.



What is a credit score?

Your credit score is a three-digit number that's calculated based on your credit report. When applying for credit, lenders check your credit report and corresponding score to determine if you're worth lending money to.

It's the easiest and simplest way for lenders to know if you're worth the risk of lending money to. A bad credit score could mean either being denied a loan or facing a higher interest rate. An excellent score means you pay less in interest since you've proven you're responsible with credit.

Why are credit scores important?

Your credit score determines your credit health. Any time you want to get a credit card or apply for a loan, expect a credit check. If you have a spotty credit history riddled with late payments, defaults and high credit usage, you might not get approved for credit options in the future.

How are credit scores used?

Anytime you want to borrow money, lenders will check your credit score. Think of:

1. Car and auto loans
2. Mortgages
3. Personal loans
4. Student loans
5. Credit cards
6. Some apartment rental applications
7. Some employment verification procedures

If your credit score is poor or even fair, your credit or loan application might get denied. Or if you're approved, you could face higher interest rates compared to people with good or excellent credit.

What's a good credit score?

The higher the three-digit number, the better your credit score is.

There are a few different credit scoring models, and different reporting agencies and credit bureaus use different ones. Both FICO and VantageScore -- the two major credit scoring models -- range from 300 to 850.

FICO ScoreRating

300-579

Very Poor

580-669

Fair

670-739

Good

740-799

Very Good

800-850

Excellent

For FICO Scores, a good credit score is between 670 and 739. For VantageScore, a good credit score range is between 661 and 780.

VantageScore

Rating

300-499

Very Poor

500-600

Poor

601-660

Fair

661-780

Good

781-850

Excellent

How are credit scores calculated?

Credit scores are calculated based on your credit report on everything from payment history to different types of credit use. Here's how FICO breaks down its score:

Payment history, 35%: On-time payment history is the biggest determining factor in your credit score. Creditors want to know if you can pay back the money you owe on time every month and until your repayment is completed.

Amounts owed, 30%: If you max out your credit cards every month, the amount you owe -- or credit utilization -- is high. This tells lenders you have a lot of consumer credit and you're a risky borrower.

Length of credit history, 15%: This is how long you've had credit in your name. If you took out student loans for college, this counts and could give you a longer credit history than you realize. It's not just open accounts; closed accounts are calculated as well.

New credit, 10%: When you apply for a new credit card or loan, it can give your credit score a boost. Keep in mind that a hard credit inquiry will cause your score to temporarily dip. It will rebound in a couple of months, as long as the minimum payments are made on time every month.

Credit mix, 10%: The variety of credit you have tells lenders you can handle many different types of accounts. While it doesn't carry as much weight as other factors, it's still a piece of the credit score puzzle.

VantageScore includes all these factors, but not necessarily at the same weights.

How do I increase my credit score?

Not everyone's credit issues are the same, which means they can't be treated equally. How you improve your credit score depends on a few factors and what works best for you in your individual financial situation.

If you're behind on payments: One late payment can cause your credit score to drop. Many late payments and even defaulting on a loan will make your score plummet. Proof of regular, on-time payments shows lenders you can borrow money and responsibly pay it back. Start making minimum payments by the due date every month. You'll see your score slowly creep up after a few months of regular payments.

If you're using too much credit: High credit utilization -- or the amount you owe -- needs to go down. A best practice is to keep your utilization below 30% (and ideally under 10%) if you can't pay your credit card balances in full every month. If you're in decent standing with your credit card issuers, request a credit increase to lower your overall utilization.

If you don't have enough credit: If you're new to credit or borrowing money, diversify your credit by applying for new lines of credit, like a credit card. Try to limit how many new lines of credit you open each year. Every time you apply for credit, your credit score gets dinged with a hard credit inquiry. Too many credit inquiries can make your credit score drop.

How do I find out what my credit score is?

There are plenty of free ways to check your credit, including:

1. **Your bank:** Most banks let you check your credit score every month for free.
2. **Your credit card issuer:** If your credit card issuer isn't also your bank, you can still get a free, updated credit score every month.
3. **Mint:** It's free to open a Mint account and use it as you wish. You'll get an updated credit score every week.
4. **Credit Karma:** Get a free credit score update from major credit bureaus like TransUnion and Equifax weekly when you use Credit Karma.
5. **Experian:** You might not be able to get it on a weekly basis from Credit Karma, but you can get your Experian credit score monthly, for free.

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