Credit Repair 101: How accounts affect your credit score

Free Mortgage Blog

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How accounts affect your credit score

There is nothing more frustrating than wanting to buy a home, and finding out your credit isn't where it needs to be. Comments such as 'your scores are too low' or 'you have too many collections' are not exactly helpful, especially when there is no follow-up dialogue on how to correct these matters. Fortunately, I can help with this and am going to share with you valuable information that will help you get you moving in the right direction.

Before we get into that, there's one critical thing you need to know. DO NOT under any circumstances hire a 'credit repair company.' You can fix your credit yourself for free, and you can do so much faster than these so-called credit repair companies can. I don't care how good their offer sounds, do not pay money to anyone for this; it's a total waste of time and your hard-earned money. **Check out our article on Say No To Credit Repair Companies to learn more.**

Whether you're building credit for the first time or repairing your credit after a significant life event, you're doing a great thing to improve your future. Before you start, it's essential to have a basic understanding of how credit works. You need to know what type of accounts exist, as well as how they both help and hurt you. This understanding is especially vital when you're plan is to buy a home soon.

So, let's jump right in:

Installment Loans are things like car payments and signature loans. They have a fixed amount due each month for a fixed term. The credit bureaus rate you on installment loans based on your payment history. The longer you pay this monthly payment on time, the better the credit bureaus like it and improve your score accordingly.

Revolving debts are your credit cards. With revolving debt, TWO different factors apply…, payment history, and credit utilization.

On-time credit card payments build up your positive payment history and will improve your score.

The percentage of your credit limit you are using also comes into play. The higher your balance is compared to your credit limit, the lower your score goes. For instance, if you have a $1000 credit limit and you keep your balance at around $900 or so, your score will suffer. This decrease in credit scores happens because you are 'utilizing' all of your available credit and are hence considered risky.

As a general rule, if you can keep your credit card balances at 30% or less than your available limit, you'll see the benefits in your credit scores. It's essential to continue using your credit cards each month to keep them active, but going forward, work to keep your revolving balances as low as possible.

A final note on credit cards: **Do NOT close your accounts.** Closing accounts lowers the amount of available credit you have, therefore increasing your credit utilization. If you close your accounts, your credit score will plummet.

Charge-Offs are either installment loans or credit cards that you haven't paid. The creditor gave up on you and closed out the account. The account is no longer available to use, but the creditor keeps reporting each month that your account is delinquent.

Let's say you had a Capital One account back in the day that, for whatever reason, you stopped paying. Even though the account closed years ago, Capital One has been reporting you late every month. Most think that closed accounts can't hurt you, but this is a perfect example to the contrary. A closed and charged-off account damages your credit just as quickly as an open account can.

Collections are accounts you haven't paid, and the original creditor has sold your debt to a collection company. What's most damaging about collection accounts is how they get reported to your credit profile. Collection companies submit your collection debt every month as if it were a brand-new account. Because of this practice, plenty of people who should have a 700 credit score instead have credit scores in the 500 range thanks to one or two listed collections.

A side note about collections: Even though collection agencies are a pain, they are trying to collect a VALID debt that YOU owe. If you want to repair or build your credit, you have to address them. There are two ways to deal with collections, either the right way or the wrong way. Keep an eye on our Blog page for our article on the proper handling of collection accounts.

Credit depth is also significant. Having a mix of credit types is incredibly helpful. If you only have one credit card, you're not going to obtain the high score your looking for very quickly. But, if you have a couple of them along with various installment accounts, your credit profile will build super-fast with on-time payments.

Even if the accounts are secured, try to set it up to where you have several open and active accounts reporting to your credit profile. The more positive information the credit bureaus have to analyze, the higher your credit score will go.

Rental History doesn't get reported to the credit bureaus, but it is an essential piece of your overall credit profile. If you have limited credit, or, have been rebuilding your credit profile, it can be particularly helpful when it's time to get a mortgage. The reason for this is that rent is your housing, the most significant expense that you have. It is not only the most significant expense in your budget, but it's also for your current residence. In the eyes of an underwriter, limited credit and past credit bumps are more comfortable to ignore if one shows a solid history of taking proper care of their rent payment.

In sharp contrast, what DOES get reported to your credit profile is defaulting on a rental agreement. When you fail to pay rent, get evicted, or bail on a lease, that information gets reported to the credit bureaus as a collection. Using the information in the paragraph above, you can quickly see how big of a problem an underwriter is going to have with the fact that you've already defaulted on a housing expense.

Disputed Accounts are any of the account types above that you've indicated to the credit bureaus that you disagree with what's reporting. There are tons of bogus information out there saying that the best way to improve your credit is to dispute negative information. This information is completely and utterly wrong. The absolute WORST thing you can do to your credit is to dispute your accounts.

This topic requires it's own blog article, it's that important. So check back on our Blog page for more specific details on why you should avoid disputing your accounts at all costs.

Now that you know about the different types of credit and how they work for you, the last thing you need to know is regarding **Late Payments**. It is not uncommon for one's credit score to drop by 200 points after a late payment. When you're building or rebuilding your credit profile, one missed payment will set you back six months or more. When you're working on rebuilding your credit, pay careful attention to your due dates. You do not want one missed payment to negate all of the hard work you've done up to now!

I hope this information was helpful! Feel free to contact us if you have any questions; we're happy to help!

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