



Building Your Credit Score

By Luke Erickson



Credit scores are used by lenders to make loan decisions. For example, if you wanted to buy a car but didn't have all the cash saved up, you can apply for a car loan. The lender will then check your credit score and use that information along with other loan application information to decide two things: 1) if you will be awarded the loan; and also 2) how much you will be charged for the loan. A high credit score, means lower costs and more opportunities.

What a credit score is:

A credit score is a number between 300-850. The higher the score the better, because this indicates that you have successfully borrowed money in the past and paid it back responsibly.

This is where it gets a little confusing, because you need a high score to get good loans, but the only way to build a high score is by getting loans and paying them back responsibly!

Reasons you might need a good credit score:

Even though credit scores were first used for lending, did you know that they are also used by other types of companies and groups to make decisions about you? These include:

Utility companies.

o Example: You're shopping for a cell phone plan with a contract. The cell phone company will check your credit score to determine if you qualify for the plan.

Apartment rentals

o Example: You're moving out of your parent's house. Landlords will check your credit to decide if they want to rent an apartment to you.

Insurance companies (auto, home, and life)

o Example: If you own a car, your auto insurance rates may be much more expensive due to a poor credit score, than it might be with a high credit score.

Elective medical service providers

o Example: You're tired of wearing glasses, and want to have laser eye surgery to correct your vision. The surgical center will decide if you are likely to pay for this surgery by checking your credit.

Employers

o Example: You apply for a dream job with a large company that promises great pay and benefits. Unfortunately, there are 8 others applying for the same position. The company may "weed out" applicants with poor credit scores.

Costs of a poor score:

Having a poor credit score may result in fewer opportunities for employment, renting apartments, elective medical or utility services. But don't forget the direct costs of getting loans and insurance. In other words, you can usually still get loans and insurance with a poor credit score, but it will cost much more. On average, this is how much extra a typical person might pay because of a lower score:

η 850-760: Will get the best rates

η 760-720: \$100 extra

η 720-680: \$300 extra

η 680-640: \$600 extra

η 640-580: \$1000 extra

η 580-300: \$over \$1,000 extra

Cosigner:

A cosigner is someone who has already established good credit. If a cosigner adds their name to your loan application, you can often qualify for loans that you couldn't get on your own. However, cosigners are on the hook if you fail to make payments. This means that if you use a friend or family member as a cosigner and you don't pay your loan, this person's score will drop along with yours, and they will have to take over your payments. In short, they will not be very happy with you!

Costs:

Loan costs can come as either loan fees or interest payments. Adding all expenses and averaging this cost over a year is called an Annual Percentage Rate (APR). This number helps you compare the costs of different loans. Keep in mind that credit card costs can be greatly reduced and even eliminated by paying off charged balances within the card's "grace period" (this period of no-interest borrowing is typically around 2-4 weeks from the time you are billed for purchases).

Scenario:

Sam is living at home and is about to start attending a local community college to earn a degree in computer science. When he finishes school, he hopes to land a job with a big computer company like Apple, Google, or Microsoft. Large companies such as these often check credit scores as part of the hiring process. Once Sam gets a job, he also plans to buy his own home or rent a townhouse, and buy a car. He knows that insurance costs will also make a difference on the total costs of his home and car. A high credit score will be a great help to Sam in landing a job, finding a place to live, buying a car and paying for a new car and insurance.

Which of the following loan(s) would be most cost-effective for building credit during the four years Sam is in school?

Options:

1) Payday loans, to buy groceries every month.

APR: 600%

Grace period on charges: No
Cosigner required: No
Credit score after four years: 510

2) Personal bank loan, to buy groceries every month.

APR: 8%

Grace period on charges: No

Cosigner required: Yes

Credit score after four years: 650

3) Secured Credit Card, to buy groceries every month.

APR: 24%

Grace period on charges: Yes

Cosigner required: No, but refundable collateral cash is required.

Credit Score after four years: 725

4) Traditional Credit Card, to buy groceries every month.

APR: 24%

Grace period on charges: Yes

Cosigner required: Yes

Credit Score after four years: 725

Click on this quiz link to try the quiz AND see the correct answer!

[Which loan is best?](#)

Source: Bingham, A. (2011). *The Road to 850: Proven strategies for increasing your FICO credit scores*. Layton, UT: CP publishing.

This article may be freely reused and shared according to the creative commons license found [here](#). Luke Erickson is a personal finance educator with University of Idaho Extension. He can be reached at erickson@uidaho.edu for comments or to arrange a free workshop at your location.