



Understanding Credit and Credit Scores

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Since this is UHMC, a test ...

1. What year did FICO credit scores begin?
2. What predictive characteristics does FICO consider?
3. How much does 10 inquiries affect your credit score?
4. What does Wes say is the worst way to choose the best loan?
5. What does Goldilocks have to do with improving your credit?



Credit / Lending Basics

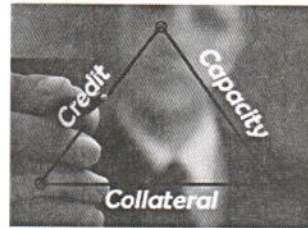
How do lenders qualify you for a loan?

“The 3 C’s of Credit”

Prepare to qualify for a loan before you need it

Ultimately, you know better than the lender

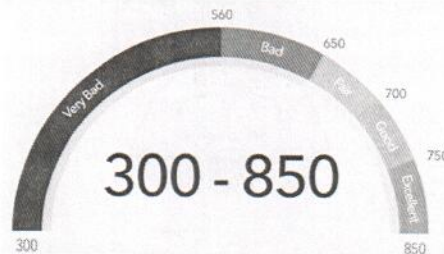
- Capacity
 - Ability to Pay
 - Debt to Income ratio
- Character (Lenders look at Credit/Credit Score)
 - Willingness to Pay
 - Do you have the commitment to pay back the loan?
- Collateral
 - Asset pledged on a loan
 - Loan to Value ratio (Loan Amount versus Collateral Value)
(don't pay, lender gets the collateral – you owe any difference/deficiency)



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Your Credit Score

- ▶ The number one thing that determines your borrowing options (including loan amount, interest rate, and terms) is **your credit score**
- ▶ Most common credit score is the FICO score. Fair Isaac Corporation (FICO), originally Fair, Isaac and Company, is a data analytics company based in San Jose, California focused on credit scoring services. It was founded by Bill Fair and Earl Isaac in 1956.
- ▶ The FICO Score is a numerical score derived through a statistical process (mathematical model) that converts reported credit information into the numerical score. This score analyzes predictive characteristics to measure credit risk (i.e., the probability of repayment or nonpayment/delinquency)



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Credit Report versus Credit Score

▶ Credit reporting bureaus compile credit reports that have your credit information from lenders, collection agencies, government agencies, property management companies, etc.

▶ Three major credit reporting bureaus are:



▶ The credit reporting bureaus in turn contract with FICO or other credit scoring companies to provide the credit scores that then are part of a consumer's credit report provided to lenders.

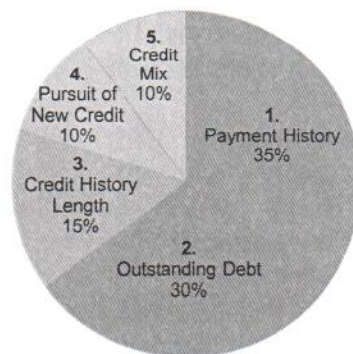
▶ Many lenders today make lending decisions based solely on a person's credit score with no consideration given to a person's ability to pay.

(remember, ultimately you are responsible to determine if you can pay back a credit obligation)



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Five Categories of FICO® Score Predictive Characteristics

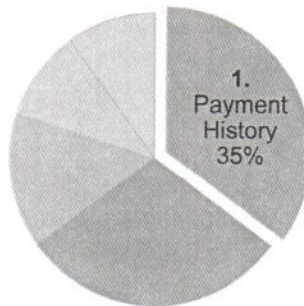


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1. Payment History (35% of scoring model)

Key Factors

- **How recent** is the most recent delinquency, collection or public record item?
- **How severe** was the worst delinquency— 30 days, 60 days, 90 days?
- **How many** credit obligations have been delinquent?
- **How much** was owed?



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2. Outstanding Debt Amount (30% of scoring model)

Key Factors

- **How much is owed** in total?
- How much is owed by type of account?
- What is the percentage of available credit limits (**credit utilization**)?
- What percentage is outstanding on open installment loans (current balance versus original loan amount)?
- **How many accounts** have balances?

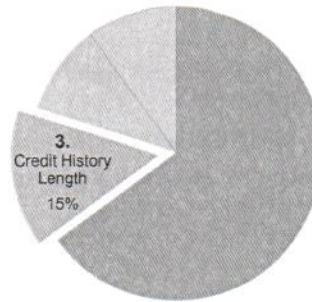


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3. Credit History Length (15% of scoring model)

Key Factors

- **How long** have accounts been **open**?
Age of oldest account, age of newest account, average age of all accounts.
- **How long** it has been since the account has been used.

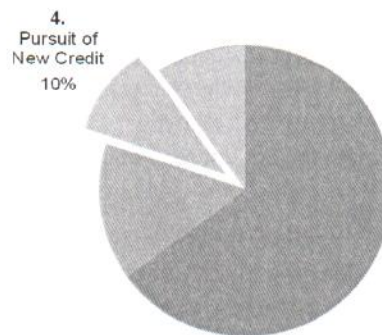


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4. Pursuit of New Credit (10% of scoring model)

Key Factors

- **New accounts**—number of trade lines opened in last year
- **Inquiries have minimal impact on score**
- FICO® Scores only consider consumer-initiated inquiries for credit posted in the last 12 months
- FICO® Scores do not consider the following inquiries:
 - Promotional inquiries
 - Account review inquiries
 - Consumer disclosure inquiries
 - Insurance inquiries
 - Employment inquiries
- Auto-, mortgage-, and student loan-related inquiries that occur 30 days prior to scoring have no effect on the score. Outside this 30-day period, auto, mortgage, and student loan-related inquiries that occur within any 45-day period are treated as a single inquiry

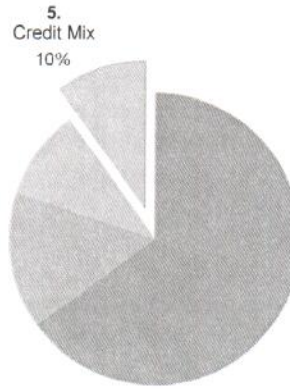


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5. Credit Mix (10% of scoring model)

Key Factors

- Is there a mix of credit product types?
- Revolving credit—credit cards
- Installment credit—personal, auto, student loans
- Mortgage loans
- How many accounts are open?



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In a nutshell ... good credit as easy as 1, 2, 3

#1 Pay your bills on time over a long period of time (24 months+)

#2 Not too much, not too little, but just right (like Goldilocks)

▶ Right amount of credit usage (credit utilization)

▶ Right mix of credit



#3 No Negative items

▶ No delinquent loan or credit card payments

▶ No collections - cell phone bills, medical bills, other collections

Remember, inquiries have a small effect

Consider the impact of closing accounts and opening accounts

Easy for FICO to drop quickly, takes a while to bring score up

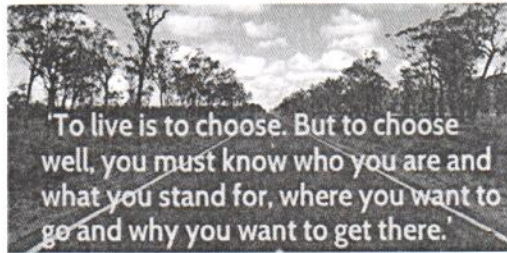


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Which loan would you choose? (mark one)

Why did you choose that one?

Loan Amount	Monthly Payment
A. \$10,000	\$158
B. \$25,000	\$553
C. \$25,000	\$390
D. \$30,000	\$562



Choosing based solely on the lowest payment is a poor way to choose.
 What are you trying to accomplish? Highest loan? Lowest Payment? Best Rate?
 What are your other options? Least interest paid – not have a loan.
 How would paying that interest affect your future?
 What would you do with the interest saved?



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The rest of the story ...

Loan Amount	Annual Interest Rate	Term in months	Monthly Payment	Est. Total Interest
A. \$10,000	18.00%	200 months	\$158	\$21,600
B. \$25,000	3.00%	48 months	\$553	\$1,700
C. \$25,000	8.00%	84 months	\$390	\$7,700
D. \$30,000	14.00%	84 months	\$562	\$17,200

- A. = a typical credit card – WOW!
- B. = good credit wants a short term auto loan to pay the least amount in interest
- C. = some minor credit issues and wants the lowest payment
- D. = wants the car they want, has credit issues

How many loans will you make over your lifetime?
 What could you do with the interest saved?



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How about for mortgages?

Loan Amount	Interest Rate	Term	Payment	Total Interest
1. \$400,000	4.50%	30 years	\$2,030/month	\$330,000
2. \$400,000	3.50%	15 years	\$2,860/month	\$115,000

Why do most people choose a 30 year mortgage?
 Even if you can't afford to pay it off in 15 years, it makes sense to pay additional amounts towards your principal.



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You can do specific examples for yourself:

A Loan Calculator helps you see the specific impact of changing each of the four loan variables (loan amount, length of loan, interest rate, payment) to help you make better financial decisions.

Here's an example of a loan calculator from Maui County FCU's website:

LOAN CALCULATOR

Use our loan calculator to help you determine the loan financing amount and payment options that are best for you.

Fill out 3 of the 4 fields to obtain the remaining field results. Do not use any punctuation when entering your data, except for the decimal point in the interest rate field.

Interest Rate	<input type="text"/>	%
Number of Months	<input type="text"/>	
Loan Principal	<input type="text"/>	\$
Monthly Payment Amount	<input type="text"/>	\$
<input type="button" value="Calculate"/> <input type="button" value="Reset"/>		

These results are approximate and are intended for information only. The accuracy of the results is not guaranteed by the Financial Institution.

Thank you for you time and Congratulations!



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