Building a positive credit history

Reports on Credit — Issue 4

It's been said that time heals all wounds. That's not always true, but the adage is accurate in the credit reporting business. Your credit report shows how well you managed your responsibilities during a certain period of time. Over time, the negative information drops off, and the positive information remains.

This issue of Reports on Credit answers these important questions:

- What can you do to build a positive credit history?
- What should you do if you begin to fall behind on your payments?
- Are credit repair clinics bad for consumers?
- How long can accurate negative information stay in your credit report?
- How do you establish a positive credit history if you have no credit at all?

What can you do to build a positive credit history?

The first step is to set up a budget and stick to it. Don't use credit to live beyond your means. But you will need a strong credit history to qualify for a car loan or a mortgage or to take advantage of the convenience credit can provide when used wisely.

Building a solid credit history starts with providing complete, accurate and consistent information on your credit applications. This helps set up your credit history correctly, and it minimizes the chance that your credit file will be incomplete or mixed with another consumer's file. So when you apply for credit, print clearly and consistently use your complete name.

Once you've established credit, building a positive credit history is simple: Pay your bills on time. The most recent information on a report is more important. So if you've paid your accounts on time for the last two to three years, a few late payments from five years ago may not prevent you from getting new credit.

In addition to paying all your accounts as agreed, here are other important factors in building a positive credit history:

- Have some credit but not too much. Having no credit history is almost as bad as having a negative credit history. If you have paid one or more accounts as agreed, you have shown you can manage your finances responsibly.
- Keep your balances well below your credit limits. High utilization (balances close to credit limits) often indicates high risk on additional debt.

- Have a mixture of credit types. It's good to have a history of repaying an installment loan, but a revolving (credit card) account is even more predictive of credit risk because you must manage your balance and monthly payment.
- Apply only for the credit you need. Several recent inquiries can indicate that you have opened new accounts that don't yet appear on your credit report.
- Be aware of your debt-to-income ratio. Mortgage lenders consider your monthly payments compared with your monthly income.
- Demonstrate stability. Some creditors consider your length of employment, length of residence, whether you own or rent, and if you have any savings.

What should you do if you begin to fall behind on your payments?

If you begin to fall behind, contact your lenders. Ignoring the situation will only make it worse. Many lenders will work with you to set up a different payment schedule or interest rate. It never hurts to ask.

You may find it easier to pay one affordable consolidated loan rather than several separate accounts. Most importantly, stop using credit until your finances are under control.

Look to professionals if you need assistance or if you don't have time to develop your own plan. Nonprofit credit counseling organizations are available to help consumers understand credit reports, contact creditors, manage debt and set up budgets.

Are credit repair clinics bad for consumers?

There is nothing any credit repair clinic can legally do for you — including removing inaccurate credit information — that you can't do for yourself for free, and their fees can be substantial, ranging from hundreds to thousands of dollars. The Credit Repair Organization Act, a federal law that became effective April 1, 1997, prohibits credit repair clinics from taking consumers' money until they fully complete the services they promise. It also requires such firms to provide consumers with a written contract stating all the services to be provided and the terms and conditions of payment. Under the law, consumers have three days to withdraw from the contract.

How long can accurate negative information stay in your credit report?

To prevent past troubles from haunting you forever, creditors must erase most negative information after seven years. Bankruptcies remain no more than 10 years. Experian® removes Chapter 13 bankruptcies after seven years. Unpaid tax liens remain 10 years from the date they are filed. Paid tax liens are removed seven years from the filing date. Credit reporting companies use the date of original delinquency or, in the case of public records, the date of filing to determine when negative information should be deleted.

How do you establish a positive credit history if you have no credit at all?

To establish credit individually for the first time, start small and build up. A department store or local lending institution is a good first step. Even if you don't have other credit, you may be able to obtain a credit card with a small credit limit — perhaps $200 or $300.

Before you apply, ask if the credit grantor regularly reports your bill-paying history to a credit reporting company. Since your intention is to build a positive credit history, lenders who don't report your information to credit reporting companies won't help you.

When you get a credit card, use it. Consistently pay your bills on time. Each month, your credit grantor will report this information. In this way, you'll establish a history of responsible credit use.

After six months, apply for another card. Continue using your credit and paying your bills on time. Before you know it, you won't have to ask for credit — credit grantors will come to you. Be careful, though, not to get carried away. Know your financial limits. Don't use credit to live beyond your means.

If you're turned down for credit, ask the credit grantor for specific reasons. Perhaps your salary is not high enough or you haven't lived at your current address long enough. Time may resolve these matters. Reapply for credit when your situation changes.

Another option is to ask a parent, family member or friend with an established credit history to cosign your loan or credit card application. If granted, the account will appear on both your and the cosigner's credit reports. Take extra care to repay your cosigned debt promptly. Failure to do so will hurt your cosigner's credit as well as your own. After a few months, try again to get credit on your own.

You also can apply for a secured credit card. To obtain a secured credit card, you must open and maintain a savings account as security for your line of credit. Your credit line is a percentage of your deposit.

But beware of the extra fees you may have to pay to obtain secured credit. Secured credit cards typically have higher interest rates than unsecured cards, and annual fees are common.

Inquiries resulting from your applications for credit will be seen by lenders, so they can affect credit scores. Lenders may view multiple recent inquiries as a sign of financial distress. For this reason, you may wish to limit how often you apply for new credit within a short period of time.

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