



5-min Warm-up  
Pg 294 Algebra Review  
1-6

# 6.6 Credit Ratings: How to Determine Your Score



# Goals:

- Determine an individual's credit rating
- Learn how to get credit for the first time

# How Credit is Granted

- Credit Rating: indication of a person's ability to secure goods, services, and money in return for the promise to pay.
- A good credit rating is developed over time, but easy to destroy
- The decision to grant credit lies with “the judgment of the creditor”

# Three C's

- **Capacity:**
  - Can you repay the loan?
  - How long have you worked, how much do you make?
  - What expenses do you have?
    - Mortgage
    - Rent
    - Car payment
    - etc

# Three C's

- **Character:**
  - Financial history
  - Have you made your payments in the past?

# Three C's

- **Collateral:**
  - Are the creditors protected from loss if you fail to pay?
  - Do you have a savings account or assets to offer as a security for you loan?
    - Car, home, valuables

# How Credit is Granted

- Credit-scoring systems:
  - Award points for various factors to determine credit worthiness
  - “Credit risk”
  - Why do credit card companies use credit –scoring systems?



- People in their mid- 30's face unforeseen expenses due to divorce, or kids
  
- You are more stable if you live in one place for longer.
  - Owning a home is better than renting
  - New cars are earn more points than old cars

- Length of time at same job
  - Kind of job
  - Income
  - Amount of current debt
  
- Savings account/checking account
  - Better to have both

- One or more credit cards in good standing
  - Department store, travel, oil cards rate lower than all-purpose bank cards
- If you have borrowed at a high interest rate you will lose points.
  - Denied credit in the last 6 months = difficulty getting new credit.

# First-time credit

- It is easier to get credit if you have had it before

# First-time credit

- Establish good credit reputation:
  - Open a charge account at a retail store where your parents have an account
  - Checking/savings account
  - Parent **cosign**
  - Join a credit union
  - Responsible employee

- Once credit is established
  - DO NOT ABUSE IT
  - TREAT IT AS A VALUABLE ASSET
  - STRENGTHEN IT

# Hypothetical Credit-Scoring Table

Fill out your credit profile by answering the nine questions below in Table 1. Circle the one response that applies to you, and then find your total score by adding up the points you got for each response. The points are found in the lower right-hand corner of each box. (For example: if you are 25 years old, you get 5 points.) Once you've totaled your score, look at Table 2 to find out how good a credit "bet" you may be.

**1.**

age?	under 25 12	25-29 5	30-34 0	35-39 1	40-44 18	45-49 22	50 or over 31
time at address?	less than 1 yr. 9	1yr. 0	2-3 yrs. 5	4-5 yrs. 0	6-9 yrs. 5	10 yrs. or more 21	
age of auto?	none 0	0-1 yrs. 12	2 yrs. 16	3-4 yrs. 13	5-7 yrs. 3	8 yrs. or more 0	
monthly auto payment?	none 18	less than \$125 6	\$126-\$150 1	\$151-\$199 4	\$200 or more 0		
housing cost?	less than \$274 0	\$275-\$399 10	\$400 or more 12	owns clear 12	lives with relatives 24		
checking and savings accounts	both 15	checking only 2	savings only 2	neither 0			
finance company reference	yes 0	no 15					
major credit cards?	none 0	1 5	2 or more 15				
ratio of debt to income?	no debts 41	1%-5% 16	6%-15% 20	16% or over 0			

**2.**

A lender using this scoring table selects a cutoff point from a table like this, which gauges how likely applicants are to repay loans.

Total Score	Probability of Repayment
90	89 in 100
95	91 in 100
100	92 in 100
105	93 in 100
110	94 in 100
115	95 in 100
120	95.5 in 100
125	96 in 100
130	96.25 in 100

# Skill 1

- We know the following information about Tim.
  - He is 49 yrs old
  - He has lived at his current address for 14 yrs
  - His current car is 9 yrs old
  - He has no car payment
  - His housing costs are \$1200 a month
  - He has a checking and savings account
  - He has been referred to a finance company
  - He has 3 major credit cards
  - His ratio of income to debt is 40%
- What is the probability that he will repay a loan?



# Determine the credit score and probability of repayment of each person

- Kourtney:
  - Born 1979
  - Lived at current address for 8 yrs
  - Age of current car: 1 yr
  - No monthly car payment
  - House cost: \$3868
  - Has only a checking account
  - Has been referred to a finance company
  - Has 8 major credit cards
  - Ratio of debt to income is 15%

What is the probability that she will repay a loan?

# Determine the credit score and probability of repayment of each person

- Travis Pastrana
  - Born 1983
  - Lived at current address: 2 yrs
  - Age of current car: 1yr
  - Monthly car payment \$244
  - Housing cost: \$359
  - Has only a savings account
  - Has not been referred to a finance company
  - Has 12 major credit cards
  - Ratio of debt to income is 24%

# Mr. Make Believe

- Age?
- Lived at current address?
- Current car?
- Car payment?
- Housing cost?
- Checking/savings account?
- Referred to a finance company?
- # of credit cards?
- Ratio of debt to income?

# Ask Yourself

- What are the “3 C’s” that creditors use to judge a person’s acceptability for credit?
- How does a lending institution determine the credit worthiness of an applicant?
- How might you establish a good credit reputation?

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