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Understanding and Improving Your Credit Score

Your credit score has a huge impact on some of the biggest aspects of your adult life. You'll likely need a decent score if you want to rent, lease or finance a car, open a credit card account, and of course, buy a home. To avoid making costly mistakes that harm your credit, you have to first understand how the process works.

When lenders and credit issuers evaluate an application, they usually want both your credit report and credit score. The score is a mathematical calculation based on the information found on your credit report. The score represents how much of a credit risk you may be to lenders. You have probably heard your credit score referred to as your FICO score, because the software used to calculate it was developed by Fair, Isaac, and Company, or FICO. All the major credit reporting companies use FICO scores, but sometimes different sets of information on their reports. FICO scores range from 300 (the highest risk) to 850 (the lowest risk), and that score depends on many factors. The major factors are the following:

✔ **Bill payment history.** If you consistently pay your bills on time, that will be reflected in a higher, less-risky score. But if you've been late in payments, had debt sent to collections, filed for bankruptcy, etc., that will factor into a lower, higher-risk score.

✔ **Your outstanding debt.** This is your total debt, including mortgage, car loans, student loans, credit cards, home-equity lines of credit, and any other type of loan reported to a credit agency. And while it may seem like lower balances will always result in better scores, a very important factor is how much available credit you don't use. Those who use credit sparingly — about 10% of allowed and no more than 30% — will have

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Do You Have Too Much Debt?

Various rules of thumb exist to help determine when debt levels are excessive. The problem with rules of thumb, however, is they don't take into account your unique circumstances. Look for these signs that your debt level may be getting too high:

✔ **You have no money left over at the end of the month.** If you have nothing left to save after paying your bills every month, your debt may be too high.

✔ **You've reached your maximum credit limit.** If you've maxed out your credit card limits or are considering obtaining new cards for additional credit, your debt may be getting out of hand.

✔ **You're only making minimum payments.** Minimum payments on credit card debt are so low, it can take decades to pay off the debt.

✔ **You don't have an emergency fund.** Ideally, you should set aside three to six months worth of living expenses in case of emergencies, such as a job loss or major home or car repair. ❍❍❍

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Credit Score

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the highest credit scores.

✔ **How long you've had a credit history.** The longer you have had and used credit, the higher your score. Even better is if you have established long-term credit with the same set of lenders.

✔ **Different types of credit.** If you have a mix of fixed-payment loans and revolving credit, you will have a higher score to reflect your variety of credit.

✔ **Hard credit pulls.** If you have applied for credit several times in a short period of time, that will signal to lenders you may be a risky option. This risk results in a lower FICO score. However, multiple applications for a specific type of credit in a short time frame does not have the same negative effect.

Now that you know what your credit score is based on, it is easier to understand why those factors are important to lenders. Applicants with credit scores of 720 and higher receive the best deals. If your score is below that, there are ways to improve it:

✔ Review your credit report to stay updated and catch any mistakes. Your score is based on information on your credit report, so any errors on the report could be costly for you even if you actually have a good credit history. Get copies of your report from the three main reporting agencies (Experian, TransUnion, and Equifax) and check each for mistakes. You are entitled to one free report from each company every year.

✔ Pay all your bills on time. Check to see if your credit report shows any late notices. If you have an otherwise good credit rating, you might be able to get the lender to remove the notice.

✔ Reduce your credit utilization rate. Your score is higher when your debt is lower as a percentage of your available credit. Pay down whatever you can and stop using credit for large purchases. If you cannot pay it down right away, ask your lender to increase your available credit. This way, your outstanding debt will be a lower percentage of available credit…but you will need to resist the temptation to draw on any of that newly available credit. Make sure you never use more than 50% of available credit.

✔ Keep credit card accounts open. This may seem counterintuitive, because once you've paid off a balance you probably want the satisfaction of closing it out. But when you close an account, you no longer have that available credit to count toward your utilization percentage. If you have more than five credit cards, close the newest ones so your long-term credit relationship stays in the report.

✔ Consider installment loans if you only have revolving credit. Fixed-payment loans like a car loan or mortgage will increase the variety of credit in your report, and you will be rewarded in your FICO score.

✔ Avoid asking for more credit as much as possible. Inquiries about more debt will show up in your credit file like hard pulls and will lower your credit score.

Your credit score can have a significant impact on the cost of any debt you incur. If you'd like to discuss this topic in more detail, please feel free to call. ❍❍❍

How to Use P/E Ratios

The price/earnings (P/E) ratio is the price you pay for $1 of a company's earnings. For example, if a company reports basic or diluted earnings of $2 per share and the stock is selling for $20 per share, the P/E ratio is 10 ($20 per share divided by $2 of earnings per share).

This ratio helps you determine if a stock is over or undervalued, compare companies in the same industry, and compare the return you are actually earning from the company compared to other investments, such as bonds or real estate.

Here's how it works. Both company A and B are selling for $50 per share. Company A has reported earnings of $10 per share and company B has reported earnings of $20 per share. Company A's P/E ratio is 5, while company B's is 2.5. Company B is cheaper and is providing twice the earning power because for the same share price, an investor is getting $20 of earning as opposed to $10 of earnings.

There are also variances in P/E ratios by industry, because there are different expectations for different types of businesses. Technology companies typically sell at larger P/E ratios, because their growth rate and earnings are higher.

The bottom line is you have to do your homework. If you want to buy a stock because it has an attractive P/E ratio, make sure you know why. It may be a great stock to purchase and is just undervalued, but make sure you know if the company is losing business or is poorly managed. It may also be that the entire industry is weak. Don't just buy a stock because it's cheap. Many investors also use the price/earnings to growth ratio, also known as the PEG ratio, because it also factors in the growth rate of a company.

Please call if you'd like to discuss P/E ratios in more detail. ❍❍❍

How Much Is Too Much to Pay for a House?

There are a few situations in life when it seems like money should be no object: weddings, birthdays…and purchasing a dream home. But in reality, a house is generally the largest investment people make over the course of their lifetime, and there is real financial danger in being blind to important factors when looking at a beautiful home. Before you let yourself fall in love with the house you're considering, think about the location, comparable houses, area trends, and a realistic budget to see if it's worth the asking price.

Location, location, location. Yes, you fall in love with the house itself, but much of its value has more to do with where it is than the high-end finishes inside. Ask yourself the following questions:

— How attractive is the area?

— How easy is it to get around?

— What is the crime rate?

— How are the schools?

This is also where the "buy the worst house on the block" adage comes in. It's not that you must buy an ugly house, but recognize that the house can change, but the location won't. So, you may as well get a bargain in a great location instead of paying for a premium house.

Sometimes a location that seems unappealing is actually undergoing positive change. It is good to see what is going on in the area that could affect the value of the home. Consider current trends in the neighborhood (you may need the help of a real estate professional) to try to determine how much value the property will hold. Ask yourself the following questions, for starters:

✔ Are young, upwardly mobile families starting to move into this area?

✔ Are new roads being built or existing highways being expanded?

✔ How is the economy? Consider national, regional, and local confidence in the economy.

✔ Is it a buyer's market with too much supply and not enough demand driving prices down, or a seller's market that may result in aggressive bidding wars over most properties?

If you've determined the house is in the location that is best for you, you still need to figure out if the dollar amount per square foot is reasonable. What are comparable houses selling for? A good real estate agent who is familiar with the neighborhood can help you figure out if the house is overpriced for the area by checking recently sold homes with similar square footage and features.

It can be difficult to determine an accurate and future value of a home, but it's a bit easier to figure how much you can afford to pay for a house. Your lender will set a ceiling for you by determining how much they will approve for borrowing based on your income-to-debt ratio and other financial risk factors. But just because you may be approved for a large amount does not mean you should spend it. Consider how those mortgage payments will factor in with everyday expenses and your lifestyle, and don't forget you will need an emergency fund for costly home repairs. Before you fall in love with a house you may not be able to afford, set a budget that works for your circumstances and house shop in that range.

Nowadays with sites like Zillow and Realtor.com, it can be hard to only look within your means. Scrolling through listings on your couch is much easier than going out to tour each one with your agent, and the pricey homes tend to have lovely photographs. So don't underestimate the pull of a seemingly perfect but over-budget home. HGTV shows are as popular as they are for this very reason: we love beautifully designed (and expensive) houses. If you find yourself having a hard time resisting the premium priced house, consider your overall financial objectives.

If you buy the most expensive house you can get, will that stall your savings for your children's education or delay your retirement? Are you wiping out your savings to make a massive down payment? Keep in mind you can always stay a few years to build up equity and then sell up…or make enough changes to a house to turn it into your dream home. A financially practical, comfortable house will always beat out a mansion that leaves you house-poor.

Please call if you'd like to discuss this topic in more detail.
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Decisions Regarding College Funding

Before you determine how much to save for your children's college educations, there are several decisions to make:

Does each child require the same level of support? While parents typically want to treat children equally, each child's needs may differ. One child may excel in school and want to attend an expensive private college, while another child may feel more comfortable at a local public university. Thus, consider the best options for each child realizing the price tag may differ.

What is your savings goal? Setting a savings goal can be difficult if your child is many years from college. To keep your savings amount reasonable, you can estimate your savings target based on today's college costs, increasing that amount every year to cover actual college cost increases. Also decide whether you are aiming for a public or private college, which have vastly different costs.

Will your child contribute toward college costs? Most children would have difficulty paying for all college costs, but you may expect your children to help fund certain costs or a certain percentage of total costs.

Will your family qualify for financial aid? Even if your child is several years from college, it is worthwhile to evaluate whether you would be eligible for financial aid. Don't just assume that you will be precluded from aid if your income is high. Also, be aware that many scholarships are awarded based on merit, not need.

Will you need loans to pay some college costs? Borrowing can put a significant strain on your finances, usually at a time when you should be concentrating on saving for retirement. However, there are a variety of loan options available, with some of the least costly available only to students.

How much can you save on an annual basis for college? You don't have to select a fixed amount to contribute annually. You may decide to increase savings in the early years or contribute an increasing amount.

How will you save for college? There are a number of ways to save for college and reduce your after-tax costs. Look into Section 529 plans, Coverdell education savings accounts, education tax credits and deductions, savings accounts in your child's name, and using IRA funds to pay college costs. Evaluate all options in light of your financial situation. ❍❍❍

Credit Issues as You Age

To help ensure you don't have credit problems as you age, consider these tips:

✔ **Apply for major loans while you are still working.** If you are getting close to retirement and know you'll need a loan, apply for credit a few years before retirement.

✔ **Make sure credit cards are obtained as joint accounts.** If you have an individual account with your spouse listed as an authorized user, the lender can close the account if you die. However, if it is a joint account, the creditor cannot automatically close the account or change its terms.

✔ **Ensure that both you and your spouse have good credit histories.** Review your credit reports, ensuring that all information is accurate and you both have sufficient history. That way, either of you will be able to obtain credit.

✔ **If you are denied credit, find out why.** It could have been an error, or you may convince the lender to consider other information. You may also be able to negotiate a compromise. For instance, if the lender is concerned about your age when considering a 30-year mortgage, perhaps a 15-year mortgage would be okay. ❍❍❍

Financial Thoughts

Approximately 75% of Americans have at least one big financial regret (Source: Bankrate, 2018).

If you retire at age 65, you have a 25% chance of living past age 90 (Source: *Forbes*, 2018).

Approximately 83% of retirees want to stay in their own homes as they age (Source: *Forbes*, 2018).

Individuals who receive financial advice have a 3% higher performance in their portfolios than individuals who do not (Source: Vanguard, 2018).

About 41% of participants in workplace savings plans have engaged in retirement planning within the past two years, while just 16% of those without access and 14% of those with access who have not participated have planned for retirement. About half of those who did plan reported using online tools or calculators, while many admitted to simply guessing (Source: The Pew Charitable Trusts, February 2018).

When asked what they would do with a $10,000 windfall, only 36% of respondents said they would set it aside for retirement (Source: The Pew Charitable Trusts, February 2018). ❍❍❍