

## Episode 127: The 5 C's of Credit

**Patti Brennan:** Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have \$20 or \$20 million, this show is for those of you who want to protect, grow and use your assets to live your very best lives. I was thinking about a topic that you might want to hear about. I was doing some searches and I went on Google, like we all do. I was curious, what are the top financial searches on Google?

I was surprised to see what they were. The first one doesn't surprise me, it's on income taxes. Second one, mortgages and credit. Third, insurance, then followed by college and then estate planning. The one that surprised me was insurance. We're not going to cover all of these topics today. Certainly, income taxes alone could be a whole course, much less a podcast.

I did think it might be interesting for all of you to learn about the five Cs of credit, because whether you are young -- young families, children of our clients -- or older, this is important. Listen up, because there's a huge change that is coming this summer. What are the five Cs of credit? Number one, capacity, has to do with your income. What are the ratios? The key ratio is your debt-to-income ratio.

They want to make sure that your debt payments are no more than 38 percent. Housing-related payments should be no more than 28 percent. So capacity is your maximum ability to take on any new debt? Second, is capital. Here is the lesson, be a good saver! Because if you have capital, that's a really good sign to a lender. Capital is the second C. The third C is collateral. One very important item to note is that you can't use a retirement plan as collateral for a loan.

What's interesting to some people is you can use a brokerage account and many people do. It's called an investment credit line, kind of like a home equity line of credit. They are very popular because the assets are there. If you want to do something -- buy a car, do a renovation on your home -- you can use the collateral in a brokerage account and not sell anything and pay capital gains. It's a loan just like anything else. It's not a margin loan.

They are very popular. I will say as a caveat, especially as interest rates have gone up, the downside to these is that they are not fixed interest rates. Collateral is very important. It's important to know what's good collateral and what's not. Most important for all of you is that it's not your retirement plans. Please, don't use your 401(k) as a loan. That's probably the last thing that I'd like any of you to be falling back on.

The fourth C is the conditions. What do I mean by that? As we saw the result of the financial crisis, before the financial crisis, things were way too loose. People were getting loans that shouldn't have been getting loans. People were getting mortgages that shouldn't have been getting mortgages. What are the lending conditions present at the time that you're looking for that credit? They have become much, much tighter as a result of the financial crisis.

While they've loosened up a little bit, they're still pretty tight. Good luck getting a mortgage within a short period of time. That's what I mean by conditions. Last but not least, is character. That's the fifth C and it's a biggie. By that I mean, what is your history as it

relates to making your payments? That's really important to a lender. Do you fulfill your promises? Do you have that Character?

To summarize, capacity, capital, collateral, conditions, and character. Now, we all have probably heard about FICO scores. You might wonder, "What really goes into that score I get?" First and foremost, just to give you a range, if you have a FICO score between 670 and 739, that's considered good. Not bad, just good. If you're between 740 and 799, that's very good. If you're over 800, that's excellent.

Why is that relevant? That'll determine what your interest rate is, so you really want to pay attention to your FICO score. What are the factors that go into that number that you get? Here's what they are. 35 percent of that score relates to your payment history. Again, character. Make sure you're making those payments on time. 30 percent is the overall amount that you owe. 15 percent is the length of history. If you are just graduating from college, you've never had a credit card, probably a good idea to get one. I'm going to give you some dos and don'ts as it relates to that process.

What you want to do is you want to begin to develop and create some of that history. 10 percent has to do with how many credit cards you have out. The last 10 percent is the type of credit that you use. Is it credit card debt? Is it mortgages, car loans, etcetera. Again, I said it at the beginning of the show, listen up. It's really important because the way that FICO is going to work going forward will change sometime during the summer of 2023.

It's changing in a big way. What's changing is that they're going to go back, and they're going to do these measurements over a period of 24 months. No more games anymore. I can tell you that I've seen mortgage brokers counseling people on how to bump up their scores over several different months, because it was much more of a snapshot. Now, they're going to look over 24 months. What that means is, don't be surprised if your FICO score goes down by 20 points or more, depending on those factors that I alluded to earlier.

That's a big deal. Some of you listening might find that their FICO score goes up. The most important takeaway is, it's changing. Understand how you're going to be affected by this new scoring. What are some of the things that you can do to improve your FICO score? Number one, make sure you're making your payments on time. That is just so important. Think about paying it off every single month.

Why do I say that? The reason for that is, it improves your utilization score, which is another factor. All that means in English is that if you have credit on a credit card available of \$15,000, and if you only owe \$1,000, and you pay it off quickly, your score, your utilization factor is going to be much, much better. Really think about aggressively paying off those cards every month. Don't open too many credit cards all at once. Again, that's a factor they really look for. On the flip side, even though you may not use it anymore, don't close those accounts.

This isn't changing and I don't understand why. For whatever reason, that actually makes your score go down if you close credit cards and things of that nature. My suggestion to those of you who use credit cards, best thing I can tell you, put your credit cards in a glass of water and put the glass of water in the freezer. Number one, if you tend to use credit cards a lot, you're going to have to wait until that ice melts before you can use that card.

If you don't use it, if you're inclined to close it, you don't even need to take it out of the freezer. That's just a little tip you might want to consider. Finally, for those of you who do carry a balance, consider transferring your balance to a transfer credit card. I'll give you some examples. Right now, for example, Citi Simplicity card offers zero percent for 21 months on balance transfers, and zero percent for 12 months on new purchases. That's probably the best deal that we've seen out there right now.

It's one of those things you want to continue to research. Capital One offers zero percent for the first 15 months. Bank of America also offers zero percent for the first 21 billing months on transfers for the first 60 days. Nobody is doing it on new purchases, so that's why I like that Citi card right now. For those of you who carry a balance, that won't hurt your score, it'll improve it, and here's why.

If you're not paying that 21 percent interest, you're going to be able to be much more assertively paying down that balance. That's going to be so empowering. If you have multiple cards with balances, there are several theories on how to get rid of that debt. One would be, go to the highest interest rate and pay that down. Another theory, and it's more a behavioral one, go to the one that has the lowest balance. Get rid of it.

I've got to tell you, that is the most liberating feeling in the world for those people who do it. If the balances are significant, don't fool around. Consolidate them, move it over into one of those balance transfer credit cards, and get rid of that debt. Those are just a few of the things that I wanted to share with all of you regarding credit. It's about improving your credit scores. Just remember the five Cs -- capacity, capital, collateral, conditions, and character.

Thanks to all of you for joining us today. I really appreciate you tuning in and watching "The Patti Brennan Show." If you have an idea, something that you want me to discuss, or anyone you'd like me to interview, let us know. Go to our website at [keyfinancialinc.com](http://keyfinancialinc.com). Most of all, thank you for your time, thank you for tuning in, and thank you for sharing this podcast with the people that you care about. I hope you have a great day.