Average Joe SERIES

The Nine Rules of Credit

What Everyone Needs to Know

Richard Moxley

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Dedication

This book is dedicated to my wife, Jessilyn, who is also my best friend and, of course, to the "monsters" that I love Ben, Ellie, Addisyn, and Joshua. Thank you to the rest of my family for their support and ideas. To everyone else who has influenced my life and the creation of this book; any success I have is because of you.

Introduction

If you live in Canada, it is safe to assume that you are carrying at least one form of debt — credit card, student loan, vehicle loan, and/or mortgage. Even if you don't have any debt, and you live on this continent, you are forced to play the credit game! That's right, a real-life game with rules to follow, strategies for success, penalties for failure, and even personal rankings known as your credit score. How well you play this game will not only determine your interest rates, but also whether you get approved for a property of your own, a place to rent, the premium on your vehicle insurance, a job, or even a parking spot. If you don't know all of the Nine Rules of Credit, no worries — you're the "average Joe" so this book was written for you!

Think you have good credit? You may be paying your bills on time, but what about the other eight rules? If promptness is the only rule you know, what's the likelihood of you wrecking your credit unknowingly? I am not a gambling man, but even I can see that the odds are not good. Is this a chance you're willing to take with so much riding on your credit? You need to learn all the rules in order to play this game well.

For the average Joe, applying for any type of financing can be a scary and complicated process. Let me assure you that I've done everything possible to make this book a completely different experience for you. I think the average Joe learns best through stories so I've tried to demonstrate all my main points with real-life stories based on my clients' experiences (note that the names have been changed to protect my clients' privacy). I have also added some personal stories of my own.

I understand the Rules of Credit and how bankers are trained to think about credit because I've been dealing with them on a daily basis since 2006. I have agents that work at the credit reporting agencies (the companies that rank you on your gameplay) on speed dial, and have met with the underwriters who review loan applications. I have also witnessed thousands of different scenarios that can happen to your credit score, depending on whether you follow the Nine Rules of Credit or not. It doesn't matter if you are just beginning, rebuilding your credit, or trying to maintain the credit you already have. I promise to teach you the inside credit secrets and all the helpful tips I've learned along the way.

"Knowledge is power," as the saying goes. The truth you can learn from this book will not only allow you to always be approved based on your credit, but will also save you hundreds of thousands of dollars over your lifetime. Derek Bok, an American lawyer and educator said it best with this quote, "If you think education is expensive, try ignorance." With the information inside these pages, you will always be able to play the credit game to win.

I also include valuable tips and tools on my websites:

www.TheAverageJoeBook.com

www.eCreditFix.ca

One

Your Credit Report and Score

I was sitting on an overturned bucket in a friend's backyard in a village just outside of Salta, Argentina, when Hermano Gomez asked me if I thought he should apply for a credit card. Are you kidding me? Here? They lived in what would be considered by North American standards to be a shack, with only two rooms with dirt floors, and no indoor plumbing. Gomez had three children and a wife, all crammed into this tiny, tin-roofed home. The taxi my companion and I took to get to this family's house was, I'm sure, one of the first cars ever off the assembly line. The majority of the houses in the area didn't have phones or microwaves, and owning a personal computer was reserved for the very wealthy.

"Why a credit card?" I asked.

"To buy a new television, of course," the family responded.

One thing South Americans share with North Americans is a passion for TV. It is common in South America to see a house without a real door and glassless windows with a satellite dish on the roof so that they can follow their favourite soccer team and watch the occasional Telenovela (Spanish soap opera).

It was 2004 and I had been in rural South America for more than a year. I was becoming accustomed to the carefree lifestyle that the people there enjoyed. Few owned watches; no one had cell phones; there was no such thing as rush-hour traffic; and nobody owed any debt, which made everyone there so much more relaxed. There were no such things as mortgages, loans, or credit cards. That is why I was so shocked when Gomez asked me for advice on credit.

As so many of us do, I repeated to him what my parents told me: "Credit cards are like the devil; fun at first, but they have a tendency to burn you in the end." Maybe I didn't use those exact words, but I had no clue about credit, except that it could be dangerous. It always seemed to be such a huge burden for anyone that became dependent on it. My advice was simply to stay away from credit because like most people, I knew little about it.

When I returned home to Canada in the middle of 2005, I was quickly immersed back into the "real world," where the "buy now, pay later" mentality was the usual way of life. Not long after my return to Canada, I decided to become a mortgage broker. I had advised the wonderful family in Argentina to avoid credit cards and debt all together, and now I was doing a 180-degree turn by helping fellow Canadians get into huge amounts of debt!

I believe that mortgages are a different kind of debt; they are a necessary evil in North America. Most of the top financial gurus call this type of financing "good debt" as opposed to bad debt, which is debt unsecured to a house, a vehicle, or another asset. I personally don't label anything that takes money out of my pocket as a "good" thing, no matter what it may be attached to. The only assets I want to have in my portfolio are ones that continue to put money into my pocket on a regular basis. Of course, my wife and children are the only exceptions to this rule!

Once I started working at a national mortgage brokerage, I learned a lot about finances and even more about credit. Just like most new mortgage agents, it was up to me to find my own clients. I was starting all over again in a brand new industry. Because I am fluent in Spanish, I came up with what I thought was a great idea. I would help Spanish-speaking families with their mortgage financing. I had no problem finding families who wanted to buy their own homes instead of renting them. I was ecstatic about all the success I was having, but then I kept running into one very big problem. Many of my clients had little or

no established credit. Even though my niche clients were employed and had managed to save for their down payment, very few banks and mortgage lenders would provide their mortgage financing without them having established credit. It is true that there are programs that allow people to use alternative forms of credit, but these programs are aimed at immigrant families who have been in North America for less than three years.

I continued to work with immigrants but because I needed more business to survive, I also began working with first-time home buyers. I was 23 at the time and I figured that this was the typical age of other young persons who wished to buy their first property. I found many young people interested in purchasing their first home; yet, I ran into the same problem as with my immigrant clients. Although these young people were gainfully employed, and had saved or been gifted money for the down payment, their credit history was limited. Once again, many of the banks and mortgage lenders would not accept people from this category for mortgage financing.

You may think that people from the younger age group or immigrants were the only categories that had problems with credit, and that I would have more success working with those with more life experience. Sadly, I learned that this was not always the case. A person's age seemed to have little bearing on how established his or her credit was. Almost everyone I received an application from was either denied a mortgage because they had no credit history, or they had been forced into higher interest rates due to having bad credit. It became apparent to me that the average person had no clue how to achieve, maintain, or improve his or her credit. It made no difference whether the person was an immigrant, first-time home buyer, or the average Joe.

1. Apply for Your Credit Report

I began to spend more time with my clients reviewing their credit history. I learned that very few had ever seen their own credit report, and no one seemed to know how to improve a poor credit rating.

Credit reports are copies of all your credit account information that is received by both Equifax and TransUnion. Equifax and TransUnion are the two major credit reporting agencies in the world. Their job is to take all the individual credit accounts that you have and then rank you based on a scoring system. Your credit score is also known as a Beacon score, Empirical Credit Scoring, and Fair Isaac Corporation (FICO)

score, which are all different names that basically refer to the same thing. They are names which individual companies use to describe how well you are doing at following the Nine Rules of Credit.

Growing up, I was never taught the rules of credit, and any time the subject of credit was brought up, it was usually during a heated debate between my parents that I didn't stick around to hear! Luckily, my father did give me one piece of solid financial advice: "Pay your bills on time." Sound familiar? The problem was that neither my father nor any of the education I received ever taught me about the other eight rules of credit. It's funny how parents can give you such great advice, and then they forget to tell you how to go about achieving it! An even worse case is when your parents or teachers give you outdated or wrong information that they still swear by. I can only imagine what my parents learned about credit in the "good old days"!

After years of reading and reviewing hundreds of credit reports, I realized that TransUnion, Equifax, and even the banks do not think like the rest of us. No wonder going into the bank and applying for credit is such a scary thing for most people to do. The average Joe has no clue why he or she is being denied credit and he or she doesn't know where to begin to find the answers.

Even those who think they have great credit need to know what shows up on their credit report. If you don't know how you got there, or what makes your score go down, you're putting yourself and your financial future at risk.

Until we have a problem with credit, we assume that we know the credit rules already. Most of us are unaware that if we follow some very simple steps, the game of credit would be so much easier to play. How much time would you spend in the penalty box if you were playing hockey, but didn't know the rules? The answer is: too much! While it is true that you can always repair your credit over time — I'm not talking about a five-minute penalty for a major rule violation — it can take six or seven years! Have no fear because when you are armed with insider knowledge, you can either completely avoid the problem or improve your credit at an expedited rate. In the following chapters, I will explain the Nine Rules of Credit in full detail, along with some other important credit and money-saving tips.

If you don't already have a recent copy of both your TransUnion and Equifax credit reports, now would be a great time to apply for them. Here is how you can do that:

For your TransUnion Report (www.transunion.ca), it will cost you $14.95 for your credit report, and $7.95 for your credit score, for a total of $22.90. You can also receive your Consumer Disclosure for free if you apply by regular mail (http://www.transunion.ca/ca/personal/creditreport/consumerdisclosure/mail_en.page).

Visit Equifax to receive a copy of your credit report (www.equifax.ca). You will be given two options. You can order your report with or without the score on it. The report is free if you apply by mail but if you want the total score, it will cost $15.50.

Be very careful when you go on Equifax and TransUnion websites. They make it very difficult for you just to order your credit report and not sign up for a monthly monitoring program. If you want access to your credit report only, or with the score included, you can visit my website (www.TheAverageJoeBook.com) for the direct links to receive copies of your credit reports.

By law, each credit-reporting agency must provide you with one free report, when requested, every 12 months. However, these free copies contain the report only; they don't show your actual credit score. You can go to the credit reporting agencies' respective websites to find an application form, and directions on how to submit your request to each agency. I am frequently asked if it's worth paying the extra money in order to get the score. For the purpose of this book, on learning and understanding where you are in the credit game, I suggest you pay the extra money to know your score. I will go through why your score is important in Chapter 2.

Once you have a copy of both credit reports, go through them in detail to make sure everything is correct and up-to-date. Unfortunately, the credit reporting agencies don't make it easy to read your credit reports; you can visit www.TheAverageJoeBook.com for helpful videos.

2. Credit Score Basics

When you purchase that nice, new 70-inch flat-screen TV with your credit card, all your information is sent electronically to the credit reporting agencies. Every time you make, delay, or miss a payment on any type of account, that information is also recorded. Both TransUnion and Equifax will use that data to determine if you are a credit risk or not. Put in simple terms, you will be ranked depending on how much you will cost a bank or lender. It may be helpful if you imagine your credit score as if it were your Grade Point Average (GPA) from your high

school or postsecondary institution. Consider your individual credit accounts, such as credit cards, lines of credit, and loans, as your individual courses.

Your "credit GPA" (credit score), which is the sum of all your accounts, helps potential lenders quickly analyze how you are doing in the credit game. Unlike a GPA, your credit score will be different with each credit-reporting agency, as each company has a different way of grading that same account information. Don't be alarmed by these small variations; just keep in mind that Equifax and TransUnion have slightly different algorithms. (An algorithm is just a fancy word for a computer process that categorizes your information into a format that the average Joe can understand.)

The commonly used saying, "You never get a second chance to make a first impression" is crucial to remember when looking at the importance of your credit score. As banks and lenders review thousands of applications a day, without a high credit score, yours may be put at the bottom of the pile or turned down without someone even going through it. When you hear a student has a 4.0 GPA in school, it gives you the sense that he or she is smart. With your credit score, the higher the score, the better your first impression will be with the bank.

Other than the irregularities in each company's algorithms, your score from either company may be different because not every bank or lender reports to both credit agencies. It costs banks and lenders time and money to submit information to both reporting agencies, meaning some places report to either one or the other. That is why you could have an account show up on one report and not on the other and why it's important for you to request and review both your Equifax and TransUnion credit reports.

For an example of why it is so important to review both credit reports, I will share an experience I had with two of my clients (note that names and small details have been changed to protect my clients' privacy):

Kim and Jerry were referred to me by a financial professional because they were just turned down for a mortgage by their bank due to a low credit score. The couple was devastated that they wouldn't be able to purchase the home that they had been eying even though they were more than qualified in every other aspect. After doing a full in-depth review with them I had some good news.

The bank had only pulled their TransUnion Credit report and the low score was caused by an old Consumer Proposal (a debt relief program similar to Bankruptcy) that wasn't settled properly many years earlier, which shouldn't have showed up after so many years had passed. Jerry's Equifax credit report was 60 points higher than his TransUnion report. It also didn't have any errors on it. The good news is that some banks only focus on the Equifax credit report. I was happy to let Kim and Jerry know that they could get their dream house and I was able to refer them to a mortgage professional who could get the best rate mortgage while we got the TransUnion credit report corrected.

In theory, your credit reports should be mirror images of each other; however, the more time I spend reviewing credit reports the more I realize that having all the information correct is the very rare exception rather than the norm.

On both your Equifax and TransUnion reports, your credit score can range between 300 and 900. I'm sure you have seen many different pictures of ranking scales online, or even on your credit reports. Keep in mind that each type of financing has different guidelines. Mortgage financing is one of the hardest types of credit to qualify for as an average Joe. Therefore, if your credit is considered amazing in the mortgage category, you shouldn't have any issues in any of the others.

A credit score ranking system intended for mortgage financing would look like this:

- Poor 300 – 575
- Fair 576 – 629
- Good 630 – 679
- Excellent 680 – 750
- Amazing 751 – 900

In addition to a bad first impression, your credit score will determine the interest rate or fees that you will be charged. For example, when applying for a vehicle loan, if you have amazing credit or a score (i.e., between 751 – 900), you will get the best, discounted rate. You also won't pay any fees other than the basic set-up fees or other expenses that the seller charges everyone. If you are in the poor or fair credit category, the lenders will apply higher interest rates. The lower your credit score the more it will cost you.

Banks and lenders are a business; they don't lend money to be nice, they do it to maximize profits. A credit score gives them the ability to easily categorize their potential profitability and risk so they can charge you accordingly. To summarize, having a high credit score gives a great first impression and highly influences your cost to borrow.

3. The Importance of Good Credit

Good credit will save you hundreds of thousands, and maybe even millions of dollars, over your lifetime!

I know you may be thinking that the interest rate you qualify for is only 1 or 2 percent higher with bad credit than for good credit, so is the score really that important? You may even be able to afford the higher payments required with a lower score, so what is the big deal?

It is a very big deal. Have you ever been punched in the shoulder — maybe by a friend or an older sibling? The first time it may hurt a bit, but you usually suck it up so you can convince yourself and others that it was no big deal. However, when your older siblings take turns hitting the same spot over and over again those little punches start to add up (obviously I have some unresolved childhood issues)! Think of the banks as your older siblings taking swings at you because your credit is bad. The high interest payments eventually hurt.

The following sections discuss some examples on just how much great credit can save you from getting hurt over your lifetime.

3.1 Mortgages

Vehicle loans, personal loans, lines of credit, and credit cards all work the same way as mortgages. Being charged a higher interest rate may not seem like much on a monthly basis, but over the years it adds up.

Table 1 outlines your savings based on which category of credit you are in. It is based on a $300,000, five-year fixed mortgage, with monthly payments during a 25-year amortization period (e.g., life of the mortgage). The numbers in Table 1 are very conservative for a rate and fee increase with someone who has bad credit.

If you are an average Joe, having more than $150,000 in savings should be incentive enough to always have amazing credit; but hold on, we are just getting started.

With bad credit, not only are you paying higher interest rates, you can also expect to be charged up-front lending fees. Think of these

Table 1

How Your Credit Score Can Influence Your Mortgage Rate

Credit Type	Rate	Monthly Mortgage Payments	Monthly (Savings)	Over 5 Years (Savings)	Over 25 Years (Savings)
Excellent/ Amazing Credit (680 – 900)	3.09%	$1,433.63	$510.83	$30,649.80	$153,249.00
Good Credit (630 – 679)	3.29%	$1,464.75	$479.71	$28,782.60	$143,913.00
Fair Credit (576 – 629)	4.64%	$1,683.85	$260.61	$15,636.60	$78,183.00
Poor Credit (300 – 575)	6.14%	$1,944.46	N/A	N/A	N/A

fees as risk insurance for the lender. The more risky you are, the higher the fee. Depending on how bad your credit is, as well as other qualifying factors, your fees will generally be within 1 to 10 points of the mortgage amount. Whether you keep the mortgage for a year or just a month, you will still pay the same up-front fee.

For example, let's say you had a 550 Beacon score (credit score). Your starting fees would be 3 percent of the entire mortgage amount. On a $300,000 mortgage amount, you are not only paying more than $500 a month, but $9,000 in up-front fees. Isn't that money better in your pocket than in someone else's?

Here's an example to illustrate an average cost of bad credit:

The Robinson family has two mortgages totalling $320,000 on a house that is worth approximately $450,000. They are making monthly payments of $3,250 when they could be paying only $1,529.20 per month, if their credit was good. They are basically throwing away $1,720.80 per month because of not following the Nine Rules of Credit. That means they are paying a total of $103,248 extra over a five-year period, due to higher interest rates. If they didn't improve their credit over that five years, and continued that trend for the life of the mortgage, it would cost them $516,240. This cost is above and beyond the original house price and typical mortgage interest and charges that come along with home ownership.

I am so glad that I graduated from high school knowing how to dissect a frog and how to find the square root of 600, but where was the

class on credit? I am not saying that science and math aren't important, but just ask the Robinson's which information would have been more practical.

Money-Saving Tip

Want to have a guaranteed rate of return on your investment? How about making additional payments to your mortgage or vehicle loans? A small lump sum such as $500 a year in extra payments can bring you double-digit savings on interest (note that $500 a year is only $1.37 per day). You can also save money over the long term by switching your loan payments to biweekly or even weekly payments instead of the traditional monthly payments. This forces you to make two to four extra payments a year, which all goes to reducing your debt faster and saves you money.

For prepayment mortgage and loan calculators to estimate how much you can save, go to www.TheAverageJoeBook.com, click Lists & Tools. Under the "Tools" heading you will find "Mortgage Calculators."

3.2 Employment

The list of negatives for having bad credit is endless, but not knowing the Nine Rules of Credit can even prevent you from getting certain jobs or promotions. Accountant certifications and trustees are examples of two professions in which your title can be delayed or taken away based partially on your credit history. Whether it's in a financial institution or any other cash or account handling position, it is common to have a credit check done before you qualify for the job. Employers who perform these credit checks feel that you're less trustworthy if you have bad credit due to incorrect handling of your own finances. Even though there may be extenuating circumstances, any attempt to explain your own poor credit rating may sound like an excuse rather than a legitimate reason.

Beth, one of my clients, is an excellent example of how bad credit limited her earning power. Beth was an accountant and wanted to get a higher certification in the same field but was not able to because of her

credit history. Just because she didn't know some of the simple rules of credit, she missed out on her certification and lost an opportunity for a sizable pay increase. In Beth's case, she would have been eligible for a $40,000 per year raise, if only she had better credit. That is a huge amount to lose year after year. During the two years that it will take for her to improve her credit score in order to qualify for the promotion and the higher designation, she will lose $80,000.

3.3 Bad credit restricts options in life

For those who haven't maintained good credit, there is something worse than it costing you more money, and that is less options. In 2008, we saw the banks become much more restrictive on lending practices because of the US subprime meltdown. This financial mess didn't only affect the United States mortgage industry, it put the US into a recession, and almost every other country felt the effects of it. The recession or downturn in the economy put banks and investors on edge, and now everyone has to have better credit than they did before the crisis.

I'm sure if you stop and think about it, you could come up with a few examples of how your options would be limited with bad credit. I'm sure you have thought of setbacks such as not being approved for a mortgage, a vehicle loan, or renting an apartment. These are all true, but here are some additional things that you may not have considered:

- Shopping online by credit card.
- Receiving discounts on your general insurance premiums.
- Setting up a cell phone account.
- Setting up a home security system.
- Hooking up utilities, such as electricity and heat, can be restricted due to a low credit score.

If you don't have a credit card, it makes it hard to do the following:

- Booking a flight.
- Reserving tickets.
- Leasing a vehicle.
- Parking downtown.

Nowadays even your love life can be affected by bad credit. I have clients that have hired me specifically because their bad credit has become an obstacle to continuing in serious relationships. With finances being one of the major causes of relationship break downs, those who have been through previous divorces or separations are asking important financial questions before they get too far in the relationship such as, "How is your credit?"

To be honest, I checked my wife's credit rating before we got married. For me, there is no easier way to see the last six years of someone's financial history beyond his or her credit rating. I'm not saying that those with poor credit don't deserve love as well but it can bring up some great discussions that should be talked about before entering into a serious relationship.

As I've demonstrated, knowing how to achieve and maintain good credit can save you hundreds, thousands, or even millions of dollars. Not having to be restricted or embarrassed in any way, because you've been declined for credit or that promotion you've been working so hard for is priceless!

Now it is time to learn exactly what it takes to have good credit. The following chapters will outline the Nine Rules of Credit that you and every other average Joe should know and review constantly.

Average Joe Action Steps

1. Go to www.TransUnion.ca and request your credit report with your credit score.
2. Go to www.Equifax.ca and request your credit report and your credit score.
3. Review and familiarize yourself with each report. Circle any errors you find. (See Chapter 12 to find out how to correct the errors.)