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March 23, 2016

How Co-Signing a Loan Impacts Credit Score

Q. My FICO score is 812. It was 828 in 2013, but I think it dropped when I co-signed a Sallie Mae student loan for my grandson. Payments for this loan are being made on a timely basis, always before the due date, never missed and never late. I have several credit cards, all with zero balances. When I do use any of these credit cards, I pay the entire balance due each month. Some of these cards have very high credit lines. My question: if I contact the credit companies and ask to have the credit limit lowered, would my FICO score go back up? — Great score

A. You've got a great credit score even with the slight dip. Even though yours has come down from 828 to 812, your FICO score is still considered to be exceptional, said **Claudia Mott, a certified financial planner with Epona Financial Solutions** in Basking Ridge.
Mott said at the time you co-signed for the loan for your grandson, your score may have dropped as a result of the inquiry and the addition of the new loan amount.
"A `hard' inquiry such as the one that would have appeared at the time the time of the loan application shouldn't be part of the credit score calculation for longer than 12 months," she said. "If the loan was taken out in 2013, it's not likely that the initial inquiry would be affecting your score even though the inquiry may appear for two years."

An individual's FICO score is calculated based on five components:
1. 35% Payment history
2. 30% Amount owed
3. 15% Length of credit history
4. 10% Credit mix
5. 10% New credit

The loan may have impacted some of the other categories used in the calculation of your score such as "new credit" and "amount owed," and the combined effect of these changes probably contributed to the decline, Mott said. She said a student loan is considered an installment loan and while it might have a small effect on the amount owed, the negative impact is not as great as running up a credit card balance would be. Mott dug a little deeper. Credit cards are classified as revolving debt and are an integral part of each individual's "credit utilization ratio" (CUR). This factor compares the balances on revolving debt to the credit limit on the card. A "CUR" under 7 percent is a very good ratio and will favorably impact an individual's credit score. A ratio between 10 and 20 percent is deemed acceptable, while anything exceeding 30 percent range will negatively affect a credit score, she said. The fact that payments on the loan are being made in a timely fashion is extremely important for both you and your grandson's credit scores as "payment history" comprises 35 percent of the FICO score and payments more than 30 days late are usually reported to the three credit bureaus, Mott said.

"A late payment could remain on a credit report for seven years," she said. "Additionally, the gradual reduction in the outstanding loan balance will be a positive for your credit score over time." Reducing the limits on your credit cards is not a guarantee that your score will improve in the near term, and it could even hurt. Even though you pay off your balances each month, if the timing is such that the credit bureaus take a snapshot of your card usage after you've made a purchase and compare it to a lower credit limit, this would result in a higher credit utilization ratio at that moment in time, Mott said. That could make the score drop for briefly.
"The reduction in the outstanding loan balance over time and avoiding late payments are two factors that will certainly work in your favor over time," she said.
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