

## The Three C's of Credit

Before you consider applying for credit, make sure you understand what creditors look for when giving an approval for a loan or line of credit.

Creditors are looking for the three C's of credit: capacity, character, and collateral.

### Capacity

A creditor will view capacity as to how you are going to repay the loan. They want to know what your monthly income is and any bonuses you may receive. They want to know what your expenses are, how many dependents you have, and if you are paying child support and/or alimony.

One of the most important features about capacity is the debt to income ratio. The debt-to-income ratio is calculated by totaling all your monthly debt (for example, car payments, rent or mortgage, credit card payments), including the monthly payment for the item you are trying to finance. This number is then divided by your income. Most banks will not lend if the ratio is over 50 percent.

The following is an example of how the debt to income ratio is calculated:

Total Gross Monthly Income: \$4,000

Total Monthly Debt, Including Proposed Loan Payment: \$1,600

Debt to Income Ratio:  $\$1,600/\$4,000 = 40\%$

### Character

To determine your character, a creditor will look at your credit history and paying habits from information they get through a credit-reporting agency such as Experian, TransUnion, or Equifax. Many creditors subscribe to a special service that the credit-reporting agency offers to receive a credit score. This is known as the Fair Isaac Score (FICO). If your credit score is too low, you will be denied credit.

### Collateral

A creditor also wants to know what collateral or assets you have other than your income. This would include a savings account, investments, or property. By having assets, the creditor feels more secure because they can be liquidated if you fall into financial difficulties.

Credit grantors look at many factors to determine whether or not they will give an approval. Some of these factors include, length of employment, previous credit, length of residency, open accounts and if you have a checking and/or savings account. If all the factors are favorable you should be approved. If not, your application may be denied.

There are several reasons an application could be denied. One reason for a denial could be an incomplete and illegible application. Other reasons may be a negative credit report, excessive inquiries, overextension, an unlisted telephone number, insufficient income for the amount requested, and too short a period of employment. Whatever the reason, the creditor must notify you within 30 days of the denial by mail to let you know the reason.

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### About the Author

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