

When New Credit and Inquiries Affect your Credit Score

Every so often, we all need to apply for new credit – whether it's a mortgage, car loan, student loan or credit card – it's difficult to avoid. Applying for new credit negatively affects your credit score, but luckily, it does not have a major impact. In fact, one additional credit inquiry usually takes less than five points off your overall score. Here's what you need to know about new credit and credit inquiries:

The Basics

When you apply for credit, you authorize lenders to ask or "inquire" for a copy of your credit report from a credit bureau. When you later check your credit report, you may notice that their credit inquiries are listed. The inquiries that result from your applications for new credit are considered in your FICO score.

If you apply for several credit cards within a short period of time, multiple inquiries will appear on your report. Looking for new credit can equate to higher risk, but most credit scores are not affected by multiple inquiries from auto, mortgage or student loan lenders within a short period of time. Typically, these are treated as a single inquiry and will have little impact on your credit score.

How applying for credit affects your FICO score

Fair Isaac's research shows that opening several credit accounts in a short period of time represents greater credit risk. When the information on your credit report indicates that you have been applying for multiple new credit lines in a short period of time (as opposed to rate shopping for a single loan), your FICO score can be lowered as a result.

The effect from this varies from person to person based on their unique credit histories, but in general, credit inquiries have a small impact on one's FICO score - about 10%. Much more important factors for your score are how timely you pay your bills and your overall debt as indicated on your credit report.

Not all inquiries are treated the same

Research has indicated that the FICO score is more predictive when it treats loans that commonly involve rate-shopping, such as mortgage, auto and student loans, in a different way. For these types of loans, the FICO score ignores inquiries made in the 30 days prior to getting the loan. So, if you find a loan within 30 days, the inquiries won't affect your score while you're rate shopping.

While new credit and credit inquiries are a small portion of your overall credit, every little bit helps, so it's important to have a firm understanding of how applying for new credit may hinder your credit score. Be sure to check back next when delve into how the type of credit you use also factors into your overall score.