Using Different Types of Credit to Improve Your Score

As we've discussed in previous articles, there are five factors that make up your credit score: Payment history, amounts owed, length of credit history, new credit – and this week's topic, types of credit used.

Proving that you can manage a mix of debt lowers your assumed risk, therefore increasing your chances of getting the credit you're seeking at the best possible terms. Although it only makes up 10% of your total score, the type of credit you use does have an impact, and may determine whether you're classified as low risk, moderate risk, or high risk.

Credit bureaus like to see that you know how to manage various types of credit, such as revolving lines of credit and short and long term installment debt, as opposed to only managing a single credit card. For instance, if you have an installment loan such as a mortgage or car loan, along with that credit card, it can boost your credit score (assuming that your payment history is good) because it improves your mix of credit, and demonstrates your ability to manage different types of credit.

Conversely, eliminating debts that give you a "good" mix of debt may have a negative impact on your overall score. Ironically, while it may be tempting to pay off some loans early, it can have a negative effect on your credit score because it reduces the types of credit you use. Although, it is not recommended that you go into debt simply to maintain a variety of credit. tThe history of accounts remains on your report for years, and the types of credit you use have less of an impact on your credit than your payment history. On-time mortgage payments for over 15 to 30 years -- which constitutes 35% of your score -- for example, should outweigh any downside risk of paying off the debt early.

This concludes our round-up of the factors that constitute your credit score. Now that you know the basics, next week we'll cover practical tips you can use to raise you score, and how a high score can save you thousands.