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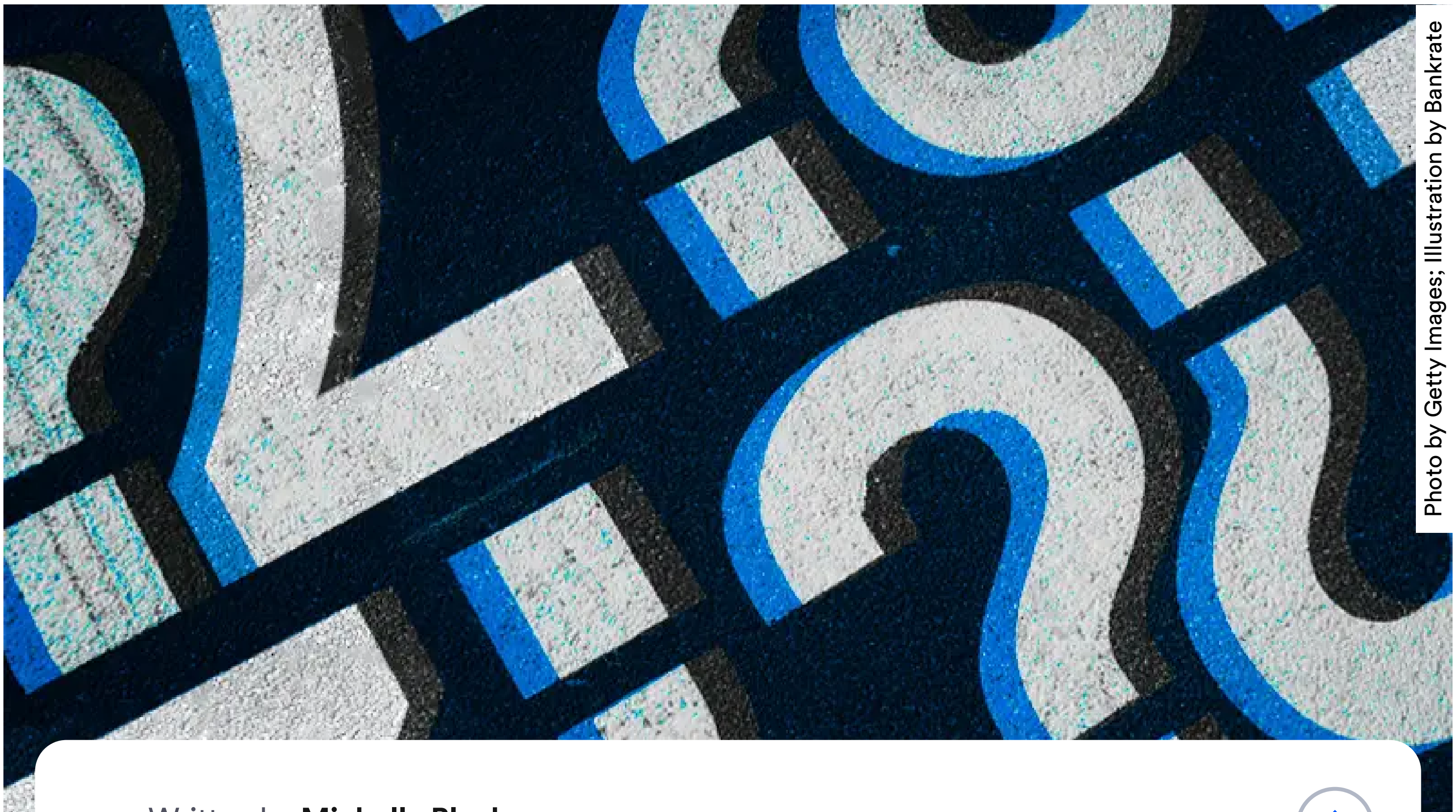
How to improve your credit score



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Improving your credit score is a smart investment of your time and energy.

Good credit often makes it easier to qualify for loans, credit cards and more at affordable interest rates. Even if you don't have immediate plans to apply for financing, good credit may save you money in other ways, like lower insurance premiums.

Here’s a breakdown of how credit scores work along with some tips you can use to try to boost these important numbers.

How to improve your credit score:

1. Check your credit reports from Experian, TransUnion and Equifax.
2. Stay on top of payments.
3. Lower your credit utilization rate.
4. Ask a friend or relative for a favor.
5. Take advantage of score-boosting programs.
6. Don’t apply for new accounts too often.

How your credit score is determined

The two most popular types of credit scores in the United States are FICO and VantageScore. Lenders use these credit scores to help estimate the risk of doing business with you when you apply for a new loan or credit card. (The majority of lenders — 90 percent in fact — use FICO scores for credit decisions.)

Regardless of the brand, at its core a credit scoring model is a complex software program. It evaluates the details of your credit report and estimates the risk that you'll pay an account 90 days or more late in the next 24 months.

A scoring model may consider the following (and more) when it calculates your credit score:

- Whether you've paid any bills late (and, if so, how recently and how late you paid).
- The relationship between your credit card limits and balances (your credit utilization).
- How long ago you opened your first credit account (and your average age of accounts).
- Your experience with a mixture of account types (e.g., revolving, installment, etc.).
- How often you've applied for credit in the past 12 months.

If your credit report shows years of on-time payment history, low credit utilization, and experience managing a variety of account types (e.g., credit cards, loans, etc.), your score will probably be in good shape. You've handled your accounts well in the past, so you're more likely to keep doing so in the future.

6 ways to improve your credit score

Ready to start enjoying the perks of an excellent credit score? FICO scores range from 300 to 850, with scores between 800 and 850 deemed "exceptional" by lenders.

Here are six tips that may help you improve your credit score.

1. Check your credit reports

You may find it surprising to learn that you don't have just one credit score. You don't have just three credit scores either — one from each credit bureau. Instead, hundreds (and perhaps even thousands) of credit scores are commercially available.

You can't control which credit score a lender uses to grade and assess your credit report. Yet, you can exercise some control over your credit reports, which your credit score is based on. There are many credit scores, but you have only three credit reports.

It's important to check your credit reports from Equifax, TransUnion and Experian. (Claim a free report from each bureau once every 12 months at AnnualCreditReport.com.) Fraud and credit reporting mistakes are known to happen. If errors occur, you might pay the price in the form of a lower credit score and all of the issues that can come along with it.

However, if you discover a credit reporting error, federal law lets you dispute the mistake with the appropriate credit reporting agency. If you dispute an incorrect, negative account and a credit bureau deletes it from your report, your credit score might improve as a result.

2. Stay on top of payments

Paying your bills on time is one way to show lenders that you're responsible with credit. Payment history is the most influential factor with both FICO and VantageScore credit scores. With FICO in particular, payment history is worth 35 percent of your credit score.

"You want to avoid things like late payments, defaults, repossessions, foreclosures and third-party collections," says John Ulzheimer, credit expert, formerly of FICO and Equifax. "And filing bankruptcy is a horrible idea. Anything that would indicate non-performance of a liability is going to harm your credit score."

Late payments — even occasional ones — can have a severe negative impact on your credit score. If you need help breaking the late payment habit, automatic payments and an emergency fund could both work in your favor.

3. Lower your credit utilization rate

After your payment history, your debt relative to how much credit you have available is the next most important factor in your credit score. FICO bases 30 percent of your credit score on the "Amounts Owed" category of your credit reports.

Your credit utilization ratio — the relationship between your credit card balances and limits — has a big influence here. When you pay down your credit card balances and lower your utilization ratio as a result, your credit score may improve.

So what is the perfect credit utilization rate? It may vary depending on the scoring system a lender uses. As a rule of thumb, you should aim to pay your credit card balances off in full each month. Asking your credit card issuer for a higher credit limit may also help.

"In FICO's systems, less than 10 percent (utilization) is the optimal target," Ulzheimer says. "In fact, people who have the highest average FICO scores have a utilization of 7 percent." VantageScore, on the other hand, looks for a target utilization of 30 percent or below.

"I always default to 10 percent because that's going to keep you in the good zone for both of the scoring platforms," Ulzheimer says.

The date your credit card issuer reports your information to the credit bureaus also matters. Your credit reports don't show your credit card balances and utilization in real time. Instead, the information changes just once a month — shortly after the statement closing date on your account. Whatever your credit card balance is on that date will appear on your credit report for the next month. So, paying your credit card bill early might help your credit score.

If you struggle with high balances and mounting interest payments on your cards, consider consolidating your debt with a zero percent introductory rate balance transfer credit card. A low-interest personal loan might also be worth considering.

4. Ask a friend or relative for a helping hand

Your length of credit history plays a role in your credit score. FICO bases 15 percent of your credit score on factors such as the age of your oldest account and your average age of all accounts. Older is better.

In many cases, you just have to sit back and wait for your credit scores to improve within this category. However, if you have a loved one with a well-managed credit card account, you may be able to ask for a helping hand.

If a friend or relative adds you to an existing credit card as an authorized user, it might help lengthen your credit history. Assuming the account is in good shape (for example, on-time payments and low credit utilization), becoming an authorized user may improve your score if and when the account shows up on your report.

It may be tempting, but be careful not to piggyback onto a stranger's credit card. Although there are companies who will help you "rent" authorized user status on another person's credit card for a fee, this practice may be considered fraud if you apply for financing after the fact.

5. Take advantage of self-reporting

The number and average age of accounts on your credit report can help lenders determine how well you handled debt in the past. So, those with a limited credit history can find themselves at a disadvantage. Aside from becoming an authorized user on a loved one's credit card (or in addition to it), you may be able to add information to your credit report by self-reporting.

Experian Boost and UltraFICO are two free programs that allow consumers to boost a thin credit profile with other financial information.

After opting into Experian Boost, you can connect your online banking data and give the credit bureau permission to add telecommunications and utility payment history to your report. UltraFICO Score allows you to give permission for your banking data, like checking and savings accounts, to be considered alongside your report when calculating your Experian-based UltraFICO Score.

Aside from these two free programs, there are some fee-based services that may allow you to add certain types of information to your credit reports as well. These include:

- eCredable Lift
- PayYourRent
- RentTrack

You may only want to self-report accounts with positive payment history to the credit bureaus. While Experian Boost will only add positive accounts to your Experian report, the same isn't true of all self-reporting credit services.

6. Don't apply for new accounts too often

When you apply for a new line of credit, a hard inquiry is recorded on your credit report. This type of inquiry has the potential to lower your score temporarily. A hard credit inquiry will remain on your credit report for 24 months and may impact your credit score for the first 12.

Research your likelihood of approval to ensure you're a good candidate before you apply for a new credit card. You don't want to risk lowering your score for a denied application. You should also refrain from applying for several credit cards within a short time frame or before taking out a large loan like a mortgage.

Credit scoring models do let you rate shop without a credit score penalty for certain types of loans. FICO considers multiple applications for a mortgage, auto or student loan within a designated time frame as a single hard inquiry. According to FICO, this span can vary from 14 days to 45 days. VantageScore counts all inquiries within a 14-day period as one.

Keep in mind, checking your own credit report is considered a soft inquiry and won't hurt your score. Hard inquiries and soft inquiries aren't the same when it comes to credit scoring.

Bottom line

You won't earn a perfect 850 credit score overnight. Yet each step in the right direction could bring benefits. As you move from bad credit to fair credit to good credit, you can start to save money and take advantage of more opportunities.

The best way to achieve and keep an excellent score is to develop good long-term credit habits. Pay your balances on time, keep a low utilization rate, and apply for credit only when you need it. If you follow these rules of thumb, your score should improve over time.