How to Understand and Improve Your Credit Score

A credit score is a numerical expression based on a statistical analysis of a person's credit files, to represent the creditworthiness of that person. A credit score is primarily based on credit report information, typically sourced from credit bureaus.

Lenders, such as banks and credit card companies, use credit scores to evaluate the potential risk posed by lending money to consumers and to mitigate losses due to bad debt. Lenders use credit scores to determine who qualifies for a loan, at what interest rate, and what credit limits. The use of credit or identity scoring prior to authorizing access or granting credit is an implementation of a trusted system.

Credit scoring is not limited to banks. Other organizations, such as mobile phone companies, insurance companies, employers, landlords, and government departments employ the same techniques.

Most credit scores range from 300 to 900, with the majority of people in the 600 to 800 range. To get the most favorable interest rates, you'll need a score of 720 or higher. In terms of interest rates, on average, a person with a credit score of 520 will get interest rates on loans that are three to four percentage points higher than rates given to a person with a credit score of 720.

Your credit score is one of the most important factors used to decide whether you will qualify for a major loan and what its terms will be. Every day, many would-be borrowers are denied loans, while consumers with strong credit histories are getting great rates on mortgages, car loans, and student loans. Understanding how your credit score is formulated is your fist step when applying for a loan.

1. Take advantage of the rules.

Too many credit applications can lower your score. Multiple inquiries signal that you are having trouble successfully securing a loan and may be a credit risk or undesirable borrower. However, multiple inquiries from the same type of lender, such as a mortgage company, are counted as a single inquiry if submitted over a short period of time. **Avoid multiple credit inquiries.**

2. Reduce your debt.

Creditors look for an optimal total debt load of around 36 percent of your household income. If your monthly mortgage, car loan, and revolving credit card payments total more than 36 percent of your monthly salary, you will likely need to find a way to lower your overall debt before applying for a new loan. **Reduce your debt-to-income ratio.**

3. Pay on time.

The easiest way to raise an ailing credit score is to make all your loan payments on time every month. Over the span of several months, you will likely see your credit score improve. When making credit card payments, you should set up a reminder system to help you pay on time and always pay more than the minimum due. This will prevent you from incurring large amounts of interest and will make you a more desirable borrower. **Always pay more than the minimum due.**

4. Timing is everything.

Wait 12 months following a credit problem before applying for a mortgage or a car loan. You will be penalized less for problems that are more than one year old. **Credit problems? Wait a year.**

5. Get your finances in order.

Avoid credit card purchases prior to applying for a major loan and stay away from independent finance companies with high interest rates, which reflect poor credit management. Transferring debt from one card to another is another way to reduce your credit score. Of course, paying off credit cards every month is ideal, but if that is not possible, steadily pay down the debt. **Be disciplined, act wisely.**

6. Plan ahead.

Don't open new credit card accounts right before applying for a home or car loan. Having too much available credit can lower your score. Also, the longer you have been at your current job and address, the better this reflects on your qualifications. If you plan on applying for a loan and will be switching jobs soon, apply before you start your new job. **Stay well qualified.**

The Five Parts of Your Credit Score

1. Your payment history – about 35%
2. How much you owe – about 30%
3. Length of credit history – about 15%
4. New credit – about 10%
5. Other factors – about 10%