How to Improve Your Credit Score

If your credit took a tumble over the holidays, here's how to fix it

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While the holidays have been over for weeks, the impact on your credit score may just be starting. If you opened new credit cards to nab a discount at the register, or if you're carrying a balance, your score may have taken a tumble.

That can make a serious difference in your financial well being in the year ahead. A poor score can increase your costs. A car loan, for example, could cost you as much as $5,000 more than if you had an excellent score, according to the Consumer Federation of America.

"When you have a top credit score, lenders feel more comfortable not only lending you money, but lending it to you at a lower rate than they may offer to others," says Bruce McClary, vice president of communications at the National Foundation for Credit Counseling, a group that represents nonprofit credit counseling agencies.

The most widely used score is the FICO score, created by the Fair Isaac Corp. The score typically ranges from a low of 300 to a high of 850.

Improving your credit score can take time—anywhere from a year to two years, depending on the kinds of changes needed to be made, according to the NFCC.

With interest rates starting to climb, it's more important than ever to get started now to improve your credit score if it isn't as high as it should be.

Steps to Take

Start the process quickly by taking these steps.

Check your report. Holiday shopping season is also high season for identity theft, so now's a good time to request your free credit report from annualcreditreport.com to make sure it doesn't contain any errors that could be bringing down your score. "You want to make sure that any derogatory or late payment information is correct, and dispute anything that's not," says Gerri Detweiler, a credit expert with Nav, a credit service for business owners.

You're entitled to one free copy of your report from each of the three biggest credit bureaus every year—Experian, Equifax, and TransUnion. Checking your own report will not have a negative impact on your score. In addition to checking your payment history, take a look at current and previous addresses and the spelling of your name. Any mistakes there could indicate that your file may have been combined with another. Call the credit bureau to make any corrections.

Track your credit score. It's easier than ever now to see your score for free (previously you could only access the report.) Most of the big credit card issuers will now provide the score to customers free of charge, and Discover will now give it to anyone in exchange for some personal info.

Some credit scoring models are now shifting to "trending data," which look at your credit patterns over time. That minimizes the impact of one-time events, but it also means that it may take longer for better habits to start to make a significant difference when you try to improve your credit score. "Delinquencies or late payments take time to work their way into the report," says Keith Gumbinger of HSH Associates, a company that analyzes consumer debt markets.

Make payments on time and never miss a payment. Keep an eye out for credit card bills from newly issued cards, which may be easy to miss, and set all payments to auto-pay so that at least the minimum amount due is always paid. Missing even one payment can have an immediate negative impact on your score, since more than one third of your FICO score, the one used by the vast majority of lenders, reflects on-time payments. "You need to pay all your bills on time, over time, in order to materially improve your credit score," Gumbinger says.

Improve your credit-utilization ratio. One of the key factors that go into your credit score is how much credit you use relative to how much credit you have. While you can lower this ratio by paying down debt, you can also lower it by increasing the amount of overall credit available to you. Often simply calling your issuer and asking for a higher balance can help lower your utilization-ratio. “Even if you pay all your bills on time, if your balances are high relative to your credit limits, your score could be taking a hit,” McClary says.

You should also avoid closing card accounts, even those that you use infrequently, since doing so will reduce the amount of available credit and increase your utilization ratio. One exception: It generally still makes sense to close cards that carry a high annual fee, unless you’re in the market for a large loan such as a mortgage in the next few months.

Don’t ignore other loans. Having a student loan or auto loan—and successfully paying them on time—can actually help your credit score. Having a mix of different types of credit accounts for 10 percent of the score for a typical borrower.
