Raise your credit score to 740

As lenders tighten credit requirements, getting a good interest rate -- or a loan at all -- requires that you understand how the scoring system works.

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As mortgage rates tumble, many would-be buyers and refinancers are missing the chance to lock in loans at record lows. The reason? Their credit scores aren't high enough to qualify for the best rates and in some cases are too low to qualify for any loan at all.

Credit scores are three-digit numbers lenders use to gauge your creditworthiness, and in recent years a 720 FICO credit score was enough to get the best rates and terms. Even people with lower scores could get a decent deal, and at the peak of the lending boom it seemed no score was so low that it merited a rejection.

These days, some lenders demand a 740 score for the best mortgage rates. Lower scores mean higher rates; if your scores are below 580, forget about it.

Missing out on what may be once-in-a-generation interest rates is painful enough. But less-than-stellar credit can hurt in other ways. After all, credit information is used:

- By insurance companies to evaluate applicants and set premiums.
- By landlords to decide who gets apartments.
- By employers concerned about higher risk of theft from those with troubled finances.

Clearly, cultivating good credit scores is an essential 21st-century skill.

The good news is that it's possible to boost your numbers *if* you have a handle on your finances and you know how credit scores work. After all, the median credit score is 720 on the 300-to-850 FICO scale, meaning half the adult U.S. population has a higher score and half has a lower score. Forty percent have scores over 750, and 13% have scores above 800, according to Fair Isaac, the company that created FICO scoring. (You can get an idea of your relative standing with MSN Money's Credit Score Estimator; it uses Experian's Plus score ranges, which roughly align to FICO.)

Plenty of folks are handling their credit well enough to earn good scores. You can, too. But first you need to recognize that:

- You can't raise your scores if your finances are still in free fall. If you're unable to pay your bills, you certainly can't fix your credit. Real credit score repair will have to wait until your financial crisis has been solved and you have enough money to cover your expenses, plus some extra to begin paying down your debts.

- You can't raise your scores if you don't use credit. Credit scores try to predict how well you're likely to use credit in the future by how well you've used it in the past. So while living a cash-only lifestyle may do wonders for your wallet, it won't boost your scores -- in fact, without continuing use of some type of credit, eventually your credit reports won't even generate credit scores.

- You don't have to pay credit card interest to achieve great scores. "Using credit" is not the same as "carrying a balance on your credit cards." Carrying a balance is expensive, bad for your finances and completely unnecessary. Many of us who have achieved 800-plus scores pay off our balances religiously, and we know you can build and keep great credit scores without ever paying a dime of credit card interest.

- You can't expect overnight results. You're likely to see improvement in your scores within 30 days if you pay down significant chunks of your credit card debt. But otherwise, credit repair takes time, and how much time depends on the many details of your credit reports. If you have serious black marks, such as bankruptcies or foreclosures, you can see significant improvement in your scores as time passes but you may have to wait until those negatives drop off your credit reports before you can join the 700-Plus Club.

Now that you understand the basics, you can use the following techniques to get your scores over 740.

You have to nail the basics

Patrol your credit reports. Your credit scores are based entirely on the information in your credit reports on file at the big three credit bureaus: Equifax, Experian and TransUnion. If the information is wrong, your credit scores could suffer. You can get your reports once a year for free from the government-run AnnualCreditReport.com; you can buy subsequent copies directly from the bureaus or from MyFico.com. Dispute any serious errors, such as:

- Accounts that aren't yours.

- Reports of late payments when you paid on time.

- Bankruptcies older than 10 years or accounts that were wiped out in bankruptcy but are listed as still due.

- Other negative information that's older than seven years (the seven-year clock typically starts 180 days after the account first went delinquent).

Get a major credit card. Retail cards and gas cards can help you build your credit history initially, but to get your scores into 700-plus territory you'll want at least one big kahuna: Visa, MasterCard, Discover or American Express. If you can't qualify for a regular card, consider a secured version, for which you make a deposit with an issuing bank. Just make sure the card reports to all three bureaus and that it converts to a regular credit card after 12 to 18 months of on-time payments.

Arrange automatic payments for every card or loan. Credit scores are extraordinarily sensitive to whether you pay your bills on time, so don't let travel, a busy schedule or a simple brain fart trash your scores. Most lenders will let you set up automatic payments that take an amount you specify -- the minimum payment, a set dollar amount or the full balance -- every month from your checking account.

You need to have great credit to take advantage of today's lower interest rates. Liz Pulliam Weston shares some of her favorite tips.

Don't let disputes go to collections. Yes, your insurance should have covered that bill; no, you shouldn't have to pay for a broadband connection that doesn't work. But if you let a commonplace problem like these escalate, your account will be turned over to collections and become a big black mark on your credit reports. Pay under protest and get your revenge in small claims court. (Don't get sued yourself, though: Lawsuits and judgments are another major stain on your credit reports.)

Give your limits a wide berth

Spread out your debt. More than a third of your FICO score depends on how much of your available credit you're using -- your so-called credit utilization. The FICO formula likes to see big gaps between your balances (whether you pay them off each month or not) and your limits, especially on credit cards. (You're rewarded for paying down installment debt, such as mortgages and auto loans, but your scores improve much more dramatically when you pay down revolving debt such as credit cards.) In short, it's better to have small balances on several cards than a big balance on one card.

A balance is a balance. You have to worry about your credit utilization ratio even if you pay your balances in full each month. The balance that's reported to the credit bureaus is typically the one on your last statement, not the balance that's left over after you pay your bill. So if you charge $9,000 on a $10,000 card, it's going to look like you're using 90% of your limit (which is really, really bad), even though you paid off the balance in full when you got the bill.

Shoot for 10%. The less of your available credit you use, the more FICO rewards you. Keeping your credit utilization below 30% on your cards is good; getting it below 10% is even better. If you regularly use more, ask for a higher limit, spread your charges out on more than one card or make two payments every month -- one just before your monthly statement closing date to lower the balance reported to the credit bureaus and a second one just before the due date to avoid late fees.

Push back against lower limits. Credit card issuers are reducing limits right and left; in fact, one banking analyst estimated that the newly risk-averse companies would slash $2 trillion of the

$5 trillion in existing credit limits. This can be awful news for your credit scores, but you can and should try to push back. (Read "Thaw out your frozen credit" for details.) If you can't get the issuer to reverse its decision, move your balance elsewhere.

3 strategies for lowering utilization

Move debt to installment loans. If you've got high balances that you can't pay down quickly, consider transferring the debt to a personal installment loan. The interest rate you'll pay is typically higher -- 13% or so for people with good credit, compared with less than 10% on many credit cards -- but the scoring formula treats installment loan balances more kindly than the same debt on credit cards.

Or move debt off your credit reports entirely. You can make debt seem to disappear by paying it off with a loan from a friend, family member or retirement plan, none of which typically show up on your credit reports. If you're tempted to tap your retirement account, though, let me be clear: I am not a fan of 401(k) loans. Lose your job, and any unpaid balance can quickly become a tax nightmare. It's an especially bad idea if your finances are on the edge, because credit card debt can be erased in bankruptcy; 401(k) loans can't.

Play the home equity card cautiously. Moving a credit card balance to a home equity loan or line of credit may improve your scores but put you at greater overall financial risk. If you fail to pay the bill, you could lose your home. Also, as with a 401(k) loan, you're turning unsecured debt that could be wiped out in bankruptcy into secured debt that typically can't.

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Walk a fine line on plastic

Don't close accounts or let them be closed. Closing accounts can't help your scores and may hurt them. Yet many issuers these days are slamming shut inactive cards rather than continue to carry these unprofitable accounts. If you've got cards you haven't used in a while, take them out for dinner or a movie, and pay the balance promptly. Better yet, use them to charge a regular expense, such as your electric bill, and arrange for automatic payments.

Apply for credit sparingly. Applications for credit don't ding your scores as much as some people fear; typically, you lose five points or less. But when every point counts, such as when you're in the market for a mortgage or a car loan, you don't want to squander any of your scores. Wait to apply for any other credit until you've secured the loan you want.