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How to Improve Your Credit Score

UNDERSTANDING
YOUR CREDIT RATING



How to Improve Your Credit Score

Your credit score can make or break your chances of getting that home loan you've been wanting ever since you found that perfect home. They're just numbers but they are actually the very things that convince your lenders you are a good risk.

So quick-fix your credit score? Sure! Why not? Unfortunately, a lot of the so-called quick and easy credit repair claims that often fill our email inboxes are no more than lip service. Worse still, they claim to do something they cannot do, preying on people's desire to find a quick fix for a major problem while at the same time milking these people for all they're worth.

That can't be good.

And the truth is there is no such thing as a quick fix to improve your credit score. At least, not legally, there isn't. But there are, however, a number of ways that you can do to move your credit score along in the right direction.

In fact, the simple task of understanding how the credit rating system works will put you in a better position than you ever were before to improve your credit score.

Step 1: Understand Your Credit Rating

What is a credit rating? And how is it different from your credit score?

Most people believe that there is no difference between a credit score and a credit rating. However, while both terms are closely related, your credit score only makes up part of the broader concept of credit ratings.

The credit rating system is not unlike the grading systems used in educational institutions. There are certain factors involved – accounts, payment habits, credit history, balances, loans, mortgages, etc. – each of which are assigned their own “weight” or score so that when you factor them all in using a particular formula, you get the total weight, which is your credit score.

Currently, there are two popular formulas used in the credit rating system – FICO (Fair Isaac & Co.) and VantageScore. The three major credit reporting agencies, Equifax, Experian, and TransUnion, are all using these two systems to calculate your credit scores.

Your FICO Score

The FICO scoring system first came out in the 1950s when Fair Isaac & Co. began its pioneering work on credit scoring. Since then, it has become a widely accepted method of determining the likelihood of credit users paying their bills. Fair Isaac & Co. and the credit bureaus that use the FICO scoring system do not reveal to the public how the scores are computed, with the Federal Trade Commission ruling it as an acceptable practice, but the factors involved more or less include the following:

- Late payments
- How long the credit has been established
- Credit used
- Credit available
- How long credit user has been in his/her present residence
- Employment history
- Negative credit information, like bankruptcies, charge-offs, collections, etc.

Since there are three credit reporting agencies that use the FICO scoring systems, there are actually three FICO scores available. Lenders will use either one of these or calculate the middle score.

Your VantageScore

As the new consumer credit risk scoring system available, VantageScore utilizes information from the three national credit reporting agencies in order to come up with more predictive scores on consumers. Moreover, VantageScore is able to score even those consumers with limited credit histories.

The credit reporting agencies say that VantageScore is more “intuitive” since it breaks down like a report card. Where the classic FICO score ranges from 300 to 850, VantageScore runs from 501 to 990:

- 901-990 = “A” credit
- 801-900 = “B” credit
- 701-800 = “C” credit
- 601-700 = “D” credit
- 501-600 = “F” credit

However, this new rap about VantageScore being a better scoring system than FICO shouldn't be taken too seriously. The two systems have never been tested head-to-head against each other so drawing conclusions now would be a bit too early.

At any rate, knowing the basics about the credit rating system will give you some idea on how to improve your credit score and how to avoid the pitfalls that could drag your credit score down.

Step 2: Get a Hold of Your Current Credit Reports

Your credit report is not the same as your credit score. For one thing, credit reports do not contain your credit score. However, they do provide a very good avenue to check for inaccuracies so that if you find that your credit score is low even though you have been making your payments on time, you can use your credit report as reference and dispute any errors you might find.

The three credit reporting agencies will provide copies of credit reports if requested, charging a small fee for each copy. The Federal Trade Commission also provides annual credit reports to consumers and the good news is that the copies are free of charge.

You can get your own copy of your credit report from the FTC website at AnnualCreditReport.com. If you're worried about consistency with the credit reports you can get from the three credit reporting agencies, don't. The credit reports you can get from the website are all copies of your existing credit reports from these three agencies.

Note that these free credit reports are being phased in over time. So they are only available to those who live in the west coast states of the United States (US). There is, however, a time table on when you can get these free credit reports if you are living in other areas of the US.

Another way for you to get free credit reports is through any of the three credit reporting agencies. However, you must have been denied credit in the past 60 days, are unemployed, on welfare, or believe your credit report contains inaccurate information due to fraud in order to get the copies for free. Otherwise, the credit reporting agencies will charge you a small fee for a copy.

Here are the three credit reporting agencies where you can get your credit report, as well as their contact numbers:

- TransUnion – 800-916-8800
- Equifax – 800-685-1111
- Experian – 800-682-7654

Once you get a copy of your credit report, check it for inaccuracies. However, don't expect that your credit reports from each of the agencies will contain the same information.

The thing is that they will most likely contain inconsistent information as these agencies get their information from different lenders while the lenders, in turn, report to different agencies. Additionally, mistakes may be made, and more often than not, any inaccuracies in your credit report are a result of these mistakes.

Correcting errors in your credit report could help improve your credit score. However, if you want results, do it through a mortgage company or a bank. First, you need proof that the item is incorrect and it must come from the creditor himself. Examples would be a letter stating that the account is not your account, that the account was paid satisfactorily, a release of lien, a satisfaction of judgment, a bankruptcy discharge, a letter for deletion of collection account and other relevant evidence.

It's going to be a lot of paperwork but it's going to be well worth it. The end result would be an improved credit score and a lower interest rate.

After checking for an inaccuracies and correcting them, it is now time for you to take positive steps in improving your credit score.

Step 3: Pay Your Bills on Time

Paying your bills on time actually accounts for 35 % of your credit score and the single biggest mistake you can make to drag your credit score down is to pay your bills late. A couple of past due payments on your credit history are like a red “F” mark on your report card and they will negatively affect your credit score in a major way, turning lenders away from you.

Remember that when it comes to credit scores, recent history is more important than past history. So even if you have been faithfully paying your bills on time but then recently missed out on a couple, this could have a terrible effect on your score. Your clean records may fall dramatically due to a few missed payments.

Moreover, some lending companies use the missed payments on your credit report as an excuse to raise your credit card interest rate. This gives you all the more reason to pay close attention to your payment habits and always making sure that you make your payments on time.

If, however, you have been remiss in your payments before but desperately need to get a loan now, the quickest solution to improving your credit score is to piggyback someone else’s credit. No, this does not involve scamming someone, but it does involve a lot of trust.

Basically, what you’re going to do is to have someone with whom you have a very trusting relationship with to add you to their credit account. Once done, their payment history is going to be reported on your credit report, too. If they have perfect credit, you also have a perfect account.

Step 4: Reduce Your Debt Load

Paying your bills on time can only do so much. In addition to making sure that you make your payments on time, you also want to reduce your debt load all together since doing so will greatly improve your score. In fact, the less debt you have the better your credit score will be.

This is an important reminder for those who use their credit cards often. Even if you religiously pay your credit card bills each month and on time, your credit score may still get hurt. This is especially true if the loan company just *happens* to access your credit score at a time prior to your making payments.

Credit scores do not often take note of your credit card payment habits. Rather, they emphasize more on who has balance in their accounts, so that if you are the sort who likes to use credit cards for the rewards they offer and pays timely, it may still look like you have a lot of debt on record.

More debt load = bad for business.

A simple tip would be to refrain from using your credit cards for a few months before applying for a loan. That way, you can address the problem of having added debts to your supposedly spot-free record.

However, note that the word used is *reduce*, not *pay off*. Credit scores are all about managing your debts well. If you pay off all your debts, you're not managing them at all. In fact, it's going to look like you're trying to pay them off quickly in order to "avoid" managing them. This could hurt your credit score.

Instead, what you should do is to pay off enough of your outstanding credits to make your credit score look good. Then, manage the rest.

Step 5: Don't Close Old Accounts

For the past few years, the one constant advice financial experts offer to consumers is to close out any old credit card accounts they have. The belief was that these older accounts, though no longer used, can negatively affect your credit score.

However, this is no longer the case today. As a matter of fact, closing your older accounts may actually hurt your credit score, rather than boost it. The reason behind this is that when you close your older accounts, you reduce the amount of credits you have available.

This, in turn, means that the outstanding balances you have in your other credit accounts will factor in more in calculating your credit scores, thus, resulting in a lower score.

Moreover, closing your older accounts can shorten your credit history. And a short credit history is a big turn-off for your credit standing, lowering your score even further.

And lastly, just as you are discouraged from closing your older accounts, avoid opening new ones as well. Especially *multiple* new credit accounts. Each time you open an account, your lender will request to take a look at your credit report and this could adversely affect your credit score. So to prevent this from happening, try not to open new accounts no matter how tempting the offer of 10% per \$100 purchase is.

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