1: Don't Mess Up!

One of the best ways to build good credit over the long term is to avoid the small and large mistakes that can stain your credit report for years.

Pay all of your bills, loan installments and credit card payments on time. Not only will you pay a fortune in late fees -- most credit cards charge over $30 for late payments -- but lenders will raise your interest rates for future credit [source: Willis].

Evictions are doubly nasty. If you're evicted, a collection agency will typically come after you for any back rent. That collection agency will report to the credit bureaus, meaning negative information will now be on your credit report for seven years. Evictions will also show up on tenant screening reports, making it difficult for you to rent future property or secure a mortgage on a future home [source: Sweet].

Avoid bankruptcy at all costs; it's the credit equivalent of poison. Bankruptcies will mar your credit report for 10 years. Above all, do your best not to cross paths with the law. Criminal convictions stay on your credit report forever (yes, forever). Even arrests that don't lead to convictions will appear on your credit report for seven years [source: FTC].

For lots more information on credit, debt and credit reporting agencies, follow the links on the next

2: Get a Good Job and Keep It

Tom Grill/Getty Images
Lenders will often consider employment and salary history in determining a borrower's creditworthiness.

On every credit report, there's a section called "identifying information." In that section is a place to record employment history. One reason for including employment history on a credit report is to give hiring managers an easy way to verify information on a job application. Another reason is to give lenders subtle information about the character of a borrower.

When lenders examine a borrower's employment history, they're looking for stability. If you've been at the same job for years and your salary has continually risen, then you're a good prospect for credit. If you constantly jump from job to job and your salary has been erratic, that puts you in a less desirable position for lenders.

Your employment history is also a good indication of your capacity to repay credit [source: Federal Reserve Board]. A person with a low average annual salary wouldn't have the same capacity to repay a large credit card balance than someone with a higher salary.

If you apply for a mortgage, salary history is one of the most important considerations that lenders will make. Usually, you'll be asked to supply income tax forms for the past two years and current pay stubs as proof of your earnings [source: Federal Reserve Board].

3: Apply for a Small Loan

Loans are a different kind of credit than credit cards. A loan is what's known as **installment credit**, since you pay back the loan, with interest, in set monthly installments. A mortgage or a car loan is a good example of installment credit. If you want to make one of these major purchases someday, it's a good idea to show lenders that you have some positive experience with installment credit.

For many young borrowers, a student loan is a great way to begin using installment credit. Student loans carry relatively low interest rates and are reasonably easy to obtain. The best part about a student loan is that you don't have to start repaying the loan until six months after you graduate. The downside is that the loan won't appear on your credit report until you start paying it back.

Student loans are just one type of installment loan. Banks and other lenders allow you to take out small loans for just about anything: a used car, an appliance, a vacation or even a personal loan. Keep in mind that the lender has the right to say no, so come prepared to make your case.

4: Get Your First Credit Card

Jeff J. Mitchell/Getty Images News
Remember, it's imperative to pay credit card bills on time.

If you've gotten your feet wet with a secured credit card or retailer card and have proven that you can pay your monthly balance on time, it's time to take the plunge. Responsible credit card use is one of the quickest and most effective ways to build a solid credit history.

An unsecured credit card is a "revolving" line of credit. This means that the lender sets a credit limit and allows you to continuously borrow and pay back your balance as long as you stay under that limit. Every month, you're required to make a minimum payment. Any balance that you carry from month to month will be charged interest.

To build healthy credit with a credit card, you must follow one simple rule: Always pay your monthly bill on time [source: Bills.com]. If possible, pay the balance in full every month. If not, at least make the minimum payment.

There are other credit card traps that can affect your credit score. Try not to carry a balance higher than 30 percent of your credit limit [source: Pulliam Weston]. FICO frowns on borrowers who have a high debt-to-credit ratio.

It's also better to stick with one credit card rather than constantly trading in for a card with a lower interest rate. Fifteen percent of your credit score is based on the length of time you've maintained a credit account

5: Get a Retailer Credit Card

Maria Teijeiro/Digital Vision/Getty Images

~~Retailer cards are easier to obtain than most credit cards, but the interest is often higher as well.~~

Another type of "training wheel" credit card is a card issued by a retail store like Macy's or Sears. In general, retail credit cards are easier to obtain than regular unsecured cards. The downside is that they don't carry as much weight on a credit report as a normal credit card [source: Pulliam Weston].

As you should with any secured credit card, make sure that the retail lender reports to all three credit bureaus. Make sure you read the fine print: Some retail cards carry interest rates as high as 30 percent. So if you're going to use one of those cards, you need to be extra diligent about paying your balance on time.

Some credit experts warn against collecting a bunch of retailer credit cards just to cash in on in-store discounts, particularly around the holidays. Every time you apply for a new card, the lender pulls your credit report. Several hits on your credit report in a short period of time will lower your credit score [source: Ulzheimer].

Another type of retailer card is a gas card or oil company card. These cards can typically only be used to purchase gas or other automotive services, while some allow you to get cash advances at station ATMs [source: Taylor]. Once again, make sure that the card reports to all three credit bureaus.

6: Get a Secured Credit Card

Prepaid Credit Cards

Prepaid credit cards aren't a good way to build a credit history because they're not really credit cards. They're actually debit cards in disguise. Because it's not real credit, your activity on your prepaid card won't be reported to the credit bureaus.

A secured credit card is a wonderful way to get your feet wet in the world of credit. Regular credit cards are called "unsecured," because there's no collateral backing up the line of credit. With an unsecured credit card, the bank allows you to borrow up to your credit limit without any guarantee that the money will be repaid.

A secured credit card, on the other hand, is tied to collateral held in a bank account. In other words, your credit limit equals your checking account balance or another amount required by the card company -- although payments for purchases made with this card won't be drawn from your bank account. If you have $500 in the bank, then your credit limit for the card is $500. If you try to charge more than $500 on the secured card, the transaction simply won't go through.

The cool thing about secured credit cards is that you can use them as training wheels for an unsecured card. Most secured credit lenders -- credit unions are excellent choices -- will let you graduate to an unsecured credit card after 12 to 18 months on a secured account [source: Grant].

Be careful, though: Some secured credit cards carry higher interest rates and fees. Above all, make sure that the secured lender reports to all three major credit bureaus. That's the only way you'll build a healthy credit history.

7: Get a Co-signer

The nice thing about building credit from scratch is that you don't have to do it alone. Most lenders will allow someone with an established credit history -- like your parents, older siblings or a family friend -- to co-sign the credit application with you.

The benefits of co-signing a credit card application or loan application are twofold: The lender no longer has to make a credit decision based solely on your thin credit history and you can "piggyback" on the (hopefully) stellar credit score of your co-signer.

As with any financial transaction, you should be careful when co-signing for credit. First of all, make sure that your co-signer actually has a good credit history. If your older brother tends to exaggerate, don't take his word for it. In the eyes of the lender, you are only as good as your brother's credit score, so ensure that you see it in writing.

Also, stick with co-signers who have a clearly demonstrated relationship with you. Family members with the same surname as yours are always the best bet. A lender might get suspicious if you walk in the door with a seemingly unrelated stranger [source: Steiner].

The most important thing to understand is that co-signing for credit means that both parties are now responsible for its timely repayment. If your dad co-signs your credit card application and you run up hundreds of dollars in late payment fees, both of your credit scores are going to take a hit.

- **35 percent** of the score is based on your **payment history**. This makes sense since one of the primary reasons a lender wants to see the score is to find out if (and how promptly) you pay your bills. The score is affected by how many bills have been paid late, how many were sent out for collection and any bankruptcies. When these things happened also comes into play. The more recent, the worse it will be for your overall score.

- **30 percent** of the score is based on **outstanding debt**. How much do you owe on car or home loans? How many credit cards do you have that are at their credit limits? The more cards you have at their limits, the lower your score will be. The rule of thumb is to keep your card balances at 25 percent or less of their limits.

- **15 percent** of the score is based on **the length of time you've had credit**. The longer you've had established credit, the better it is for your overall credit score. Why? Because more information about your past payment history gives a more accurate prediction of your future actions.

- **10 percent** of the score is based **on new credit**. Opening new credit accounts will negatively affect your score for a short time. This category also penalizes **hard inquiries** on your credit in the past year. Hard inquiries are those you've given lenders permission for, as opposed to **soft inquiries**, which include looking at your own score and have no effect on the score. However, the score interprets several hard inquiries within a short amount of time as one to account for the way people shop around for the best deals on a loan.

- **10 percent** of the score is based on **the types of credit** you currently have. It will help your score to show that you have had experience with several different kinds of credit accounts, such as revolving credit accounts and installment loans.

EXAMPLE RATES

	FICO® Score					
Auto Loans	**500-589**	**590-624**	**625-659**	**660-689**	**690-719**	**720-850**
36-month new auto loan	18.597	16.206	12.225	9.498	6.674	3.00
48-month new auto loan	18.598	16.206	12.226	9.500	6.678	3.25
Source: myFICO.com						

- **Review your credit report and correct any errors you find.** A shocking percentage of credit reports contain errors -- one study concluded that as much as a quarter of reports list wrong information that hurt an individual's score [source: CNNMoney]. Getting rid of these negative mistakes can improve a score dramatically.
- **Keep old credit accounts, even if you're not using them.** Creditors look at the debt-to-credit limit ratio and the average age of your accounts.

8: Pay Your Bills on Time

Christine Balderas/Getty Images
Pay your bills as soon as they come in to ensure a clean credit history.

Since credit reports only track money that you've borrowed, they don't include information about whether you pay your utility bills and monthly rent on time. Likewise, bill payment histories are not used to calculate the most popular credit score -- the three-digit number known as your FICO score.

What most people don't know is that the FICO score isn't the only credit score available to potential borrowers. Some alternative credit scoring models incorporate bill payment histories as one of the main criteria for creditworthiness.

The people behind FICO -- the Fair Isaac Credit Services -- recently introduced the FICO Expansion Score, which culls financial data from "alternative data sources" like rent payments and utility checks to determine creditworthiness [source: Fair Isaac Credit Services].

There's even a company called Payment Reporting Builds Credit (PRBC) that allows you to self-report payments like rent, rent-to-own purchases and utilities. PRBC might not yet have the clout of the big three credit bureaus, but a solid report from PRBC might be enough to get your foot in the door with a lender.

Of course, to earn a good grade from PRBC, you'll have to pay your bills on time religiously. Get into the habit of paying a bill as soon as it shows up in the mail, or consider setting up online accounts to pay all of your bills electronically [source: Burt].

9: Open a Bank Account

Reggie Casagrande/Getty Images
Having a savings or checking account shows lenders that you're responsible and that you have a steady income.

Although credit reports are the best way for lenders to rate your creditworthiness, there are other ways to build a record of trust. Bank accounts are a great way for a young adult to prove a level of financial responsibility before applying for that first loan.

Checking and savings account information isn't included on a credit report, but lenders will request it for most loan and credit card applications. Lenders like to know that you have a few years of experience handling your own money and making regular withdrawals and deposits. They also like knowing that you have a steady income.

Several major U.S. banks offer free checking accounts with no annual fees or minimum deposits. Remember, though, that negative bank account activity will appear on your credit report: [source: Burt]. So if you keep a low balance and end up bouncing a check, future lenders will hear about it.

10: Check Your Credit Report

In the United States, credit reports are maintained by three major credit reporting agencies: Experian, Equifax and TransUnion. If you've never applied for any form of credit, then you shouldn't have an open file with any of these agencies.

Before you apply for your first credit card or make an appointment with the loan officer at the bank, check with each of the credit reporting agencies to make sure there isn't a false credit report open in your name. More than 20,000 children and teenagers were victims of identity theft in 2008 [source: Noll]. It's possible that someone has already used your name and stolen Social Security number to apply for credit.

If that's the case, you'll need to work with the credit reporting agencies to clear your record, particularly if the identity thief ran up large amounts of unpaid debt in your name.

Credit bureaus will open a legitimate credit file in your name when a bank, credit card company or other lender reports that you've had an active credit account for at least six months. All borrowers, not just first-timers, are encouraged to check their credit reports at least once a year and scan them for errors.

Mistakes can damage your credit score for years -- up to seven years for negative information like late loan payments and 10 years for a serious default like bankruptcy [source: FTC). If you find a mistake, contact the credit reporting agencies immediately.

What's the big deal? NOW IT'S EVEN BIGGER! NO LOAN.

No matter which scoring model lenders use, it pays to have a great credit score. Your credit score affects whether you get credit or not, and how high your interest rate will be. A better score can lower your interest rate.

The difference in the interest rates offered to a person with a score of 520 and a person with a 720 score is 4.36 percentage points, according to Fair Isaac's Web site. On a $100,000, 30-year mortgage, that difference would cost more than $110,325

extra in interest charges, according to Bankrate.com's mortgage calculator. The difference in the monthly payment alone would be about $307.

What doesn't count in a score

The scoring model doesn't look at:

- age
- race
- sex
- job or length of employment at your job
- income
- education
- marital status
- whether you've been turned down for credit
- length of time at your current address
- whether you own a home or rent
- information not contained in your credit report

- **Reduce your balances on credit cards to 75 percent or less of your available credit** (25 percent is preferable).
- **Pay your bills on time**. Assuming that there are no big errors on your report, punctual payments are the most effective way to improve your score. If you look back to the page on credit score breakdown, you'll see that payment history is the most weighty of all elements of your score. This has to do with whether you pay debts back on time and in full. This may take time to raise your score dramatically, but you'll see slow and steady improvement.
- **Don't let anyone make an inquiry on your credit report unless you absolutely have to**. In general, the more inquiries, the lower your score. However, if you are shopping for a loan, make sure multiple inquiries occur within a few weeks, so that they can count as one inquiry on your score.
- **If you are planning on applying for a big loan, such as a mortgage, don't open new credit card accounts just to increase your available credit in the hopes of raising your score.** Opening new accounts will at first have a negative impact. In the long term, however, having more credit available can boost your score.
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- ## Scoring categories

- Its scale runs from 300 to 850. The vast majority of people will have scores between 600 and 800. A score of 720 or higher will get you the most favorable interest rates on a mortgage, according to data from Fair Isaac Corp., a California-based company that developed the first credit score as well as the FICO score.
- Fair Isaac reports that the American public's credit scores break out along these lines:

Credit score	Percentage
499 and below	2 percent
500-549	5 percent
550-599	8 percent
600-649	12 percent
650-699	15 percent
700-749	18 percent
750-799	27 percent
800 and above	13 percent