Five Credit Score Killers

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As Dallas bankruptcy lawyers we are often asked by our clients about what helps and what hurts their credit scores. Bankruptcy hurts, of course, but you can recover from that over time. There are other actions you can take, usually in a futile attempt to avoid or delay bankruptcy, that also can hurt your credit score. Sometimes it's best to just bite the bullet and file for bankruptcy. That way you can preserve your money for your family, rather than lose it all by trying to pay bills you can't afford. You also may be able to avoid foreclosure, and foreclosure can have a terrible effect on your credit score.

CNNMoney.com recently ran a good article about five bad habits that can kill your credit score. Here are excerpts:

As banks shy away from making risky consumer loans, a mediocre credit history just won't cut it anymore. To get the best rates on mortgages, credit cards and auto loans, you need a killer score.

Your FICO score is a numerical measure of your creditworthiness that ranges from 300 to 850. While there are a few different credit scoring systems available, it's the FICO score, created by the Fair Isaac Corporation, that most lenders look at when they check your credit.

Lenders have already raised their standards by about 20 to 40 points this year, according to Barry Paperno, consumer operations manager at FICO. So while a score in the 720 to 740 range would have gotten you the best rates on a mortgage in the past, you now need a score of at least 760 to snag the best loans.

“Requirements are higher than in the past so you’re going to have to be more diligent this year,” said Paperno.

FICO focuses on five categories when calculating your score: How much debt you have, your payment history, your debt utilization ratio (how much you owe in relation to your credit limits), how far back your credit history goes and your mix of various types of credit.

Here are a few things that can wreak havoc on your score and wreck your chances of getting an affordable loan:

1. Making late payments

A single late payment on a credit card or other loan could ding your score by as much as 110 points if you already had a great score and 80 points for someone with an average score. So the best thing you can do to improve your score is make payments on time.

“This continues to be the number one reason scores are lower,” said Paperno. “In addition to being a heavily weighted part of your score, if you're late on a payment, it's going to continue to appear on your credit report for about seven years."

Since payment history accounts for about 35% of your total score, it's really important to start paying on time.

2. Carrying a big balance

Your debt utilization ratio accounts for almost 30% of your score. So carrying too much debt will not only cost you a fortune in interest, it can also destroy your credit rating.

As part of the CARD Act that went into effect last month, credit card issuers must now include a chart with your bills that shows how long it will take to pay off your balance if you only make the minimum payments. The chart will also display how much you need to pay each billing cycle in order to completely pay off your balance in three years.

3. Closing a credit line

As credit card companies jack up interest rates and add inactivity fees to compensate for lost revenues, it's tempting to just close your accounts. But closing a line of credit could impact your debt to utilization ratio. For example, if you have two credit cards with a limit of $1,000 each and a $400 balance on one card, closing the other account will immediately double your debt to utilization ratio from 20% to 40%.

But the negative effect varies greatly. Closing one card could have a very small impact if you have lots of other high-limit cards. You can also counteract some of the impact by opening up a new line of credit. But beware: that can also impact your score.

4. Opening a credit line

“When you open a new account, you’ll knock some points off your score,” said Paperno. “The reason why is that the people who open new accounts tend to be of a higher risk level immediately after opening a new account.”

In order to open a new account, a credit card company will need to check your credit, and a typical “hard” inquiry like this will lower your score by about five points, plus the cost of opening a new line of credit typically ranges from five to 15 points.

But the temporary ding only lasts about six months, so if you’re in a stable financial situation, the score reduction could be worth it, said Paperno. ”You can look at it as a long-term strategy and go in with the idea that you might lose a few points now but in the long run you might be better off because you’ll have more credit available,” he said.

5. Defaulting

Defaulting on a loan is the single worst thing you can do for your credit, said Rex Johnson, founder of credit union consulting firm Lending Solutions Consulting. And given the down economy, more people are damaging their credit scores through foreclosures, credit card charge offs and bankruptcies. A home foreclosure, for example, might dock about 200 points off your score and a short sale could cost you around 80 to 90 points, said Johnson.

Kraft & Associates
2777 Stemmons Freeway
Suite 1300
Dallas, Texas 75207
Toll Free: (800) 989-9999
FAX: (214) 637-2118
E-mail: info@kraftlaw.com