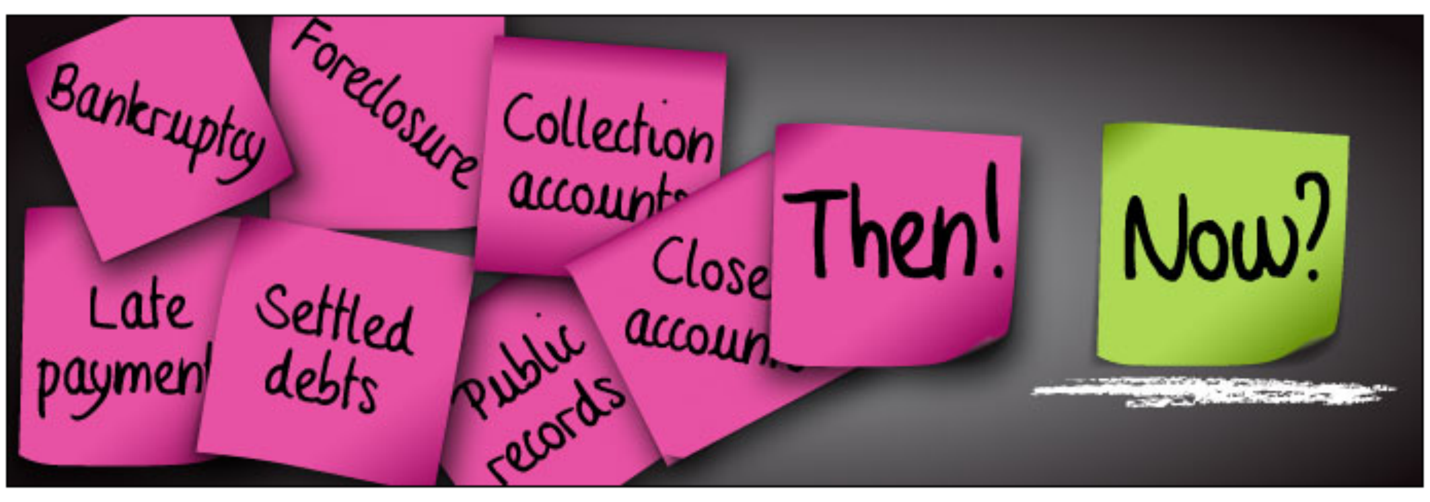
How long will I pay for my credit mistakes?

By Matt Alderton

November 13, 2013



When you fail to fulfill an obligation to a friend, rebuilding trust can take a long time. The same goes for credit obligations: If you fail to repay as promised, a warning will remain on your credit report for years, making lenders hesitant to trust you with a car loan, credit card or mortgage.

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But exactly how long will your mistakes follow you?

"The reality is, most [negative credit events] stay on your report for seven years from the date of delinquency," says Linda Ferrari, author of "The Big Score: Getting It and Keeping It, Buying Power For Life."

Yet while the seven-year rule is an oft-cited axiom among credit consultants, it doesn't always apply. In cases where it does, it's not always clear when the clock starts ticking. So, many consumers remain mystified about the longevity of their credit missteps.

To know exactly how long it will take to shake off a credit blemish, you need to know what's inside the Fair Credit Reporting Act (FCRA), which lays out when information must, by law, be removed from consumer credit reports. Here's a quick guide to seven common credit events.

1. Bankruptcy

There are two types of personal bankruptcy. When you file for Chapter 7 bankruptcy, any eligible assets are liquidated completely and most unsecured debt is forgiven. When you file for Chapter 13 bankruptcy, you may keep your assets and only a portion of your debt is forgiven; the rest is repaid via a court-supervised repayment program.

When it's removed: A Chapter 7 bankruptcy remains on your credit report for 10 years from the filing date. Because it includes some debt repayment, a Chapter 13 bankruptcy is removed sooner – seven years after the date you file.

How bad is it? "Bankruptcy is about as bad as you can get," says Rod Griffin, director of public education at Experian. "What a bankruptcy tells a lender is you didn't repay the debts you had as you agreed to repay them under contract. That's a very worrisome thing for lenders."

2. Foreclosure

When your home goes into foreclosure, the bank repossesses it because you've defaulted on your mortgage payments.

When it's removed: A foreclosure is removed from your credit report seven years from the date it's filed with the courts, according to Dave Jones, president of the Association of Independent Consumer Credit Counseling Agencies (AICCCA), a national association of credit counseling agencies.

How bad is it? "A foreclosure is a serious hit to your credit report because it indicates almost the same thing as a bankruptcy – defaulting on a major installment loan, which is a serious issue," Jones says.

3. Collection accounts

If you're late on your bills, your creditors might take a loss and sell your past-due debt to a collection agency. At that point, you no longer owe the original creditor; instead, you owe the agency.

When it's removed: The FCRA specifies that collection accounts must be removed seven years after the original debt became 180 days past due.

How bad is it? A collection account is a "big deal," Ferrari says – especially if you previously had good credit, in which case a single collection could do significant damage. "If you have 10 collections, you may lose 100 [credit score] points for all 10, but it takes just one to drop your score by 75 points," she explains.

4. Late payments

When it comes to credit reporting, a payment isn't "delinquent" until it's 30 days past due. Some issuers may not even report the late payment to the credit bureaus until it's 60 days past due. Therefore, you have at least a month after the due date to avoid credit damage.

When it's removed: A late payment – even just one – remains on your credit report for seven years from the date of delinquency.

How bad is it? The severity of a late payment depends on how late you are – 30, 60, 90 or more than 120 days late – as well as your credit history. A single 30-days-late payment, for instance, might leave a ding on your credit score, while a series of several 90-days-late payments could leave a sizable dent. "Someone who has no other late payments and has managed their credit well may see very little impact in terms of their ability to get credit," Griffin says. "However, if a person has high balances and there are other signs of risk, [late payments] can be a bigger issue."

5. Settled debts

If you're unable to make payments, you may be able to settle your debt. That means the creditor (usually a collection agency, at this point) agrees to reduce the sum you owe to within your financial means.

When it's removed: Debt settlements remain on your credit report for seven years from the original date of delinquency.

How bad is it? Although settled debts are treated as delinquencies on your credit report, the severity of the hit depends on several factors, including your credit history and the type of settled debt. Because of its size, for instance, a settled mortgage (otherwise known as a "short sale") will impact your credit more than almost any other type of settled debt.

"If you settle out of a mortgage, you're going to lose more [credit score] points than if you settle out of a credit card," Ferrari says.

Also keep in mind that, if the debt is already in collections, you're looking at some serious credit damage already.

6. Public records

Public records include information filed by local, state and federal government entities. Accessible to the general public, records include judgments won against you by bill collectors and tax liens levied by governments – both of which show up on your credit report.

When it's removed: In most states, civil judgments are removed from your credit report seven years from the filing date, according to Jones. One exception is New York, where civil judgments are removed after five years, provided the judgment has been settled.

Tax liens, Griffin says, typically remain on your credit report for seven years from the date they're paid. If they're unpaid, they can remain there indefinitely, according to Jones — unless you live in California, which requires unpaid tax liens to be removed from consumers' credit reports 10 years after the filing date.

How bad is it? On the scale of severity, civil judgments fall somewhere between settled debt and collection accounts. "They can be very significant because you owe a debt to the court," Griffin says. "A legal debt is going to have a significant impact [on your credit score]."

A tax lien – particularly an unpaid tax lien — is slightly more severe. "Paying your taxes is fairly high on the list of important things to do, so an unpaid tax lien is like a collection account or a short sale," Griffin says. "Uncle Sam is going to get paid, so you're going to have to pay that debt one way or another."

7. Closed accounts

When you close an account, the creditor no longer provides you with services in exchange for payment. A record of the account's existence, however, remains on your credit report.

When it's removed: If a closed account has late payments on it, the account will be removed from your credit report when the negative information associated with it falls off — seven years after the original delinquency. A closed account with a flawless payment history will remain on your credit report for 10 years after the date of last activity.

How bad is it? Accounts closed in good standing will cast a positive glow on your credit. Still, regardless of the payment history, a closed account could harm your credit score because it changes your credit utilization – the amount of available credit you're using compared to your overall credit limit.

Good news

Properly cared for, even the deepest credit wounds eventually heal.

"Start re-establishing good credit immediately," Ferrari says. "Get a secured credit card and start using it, paying it off every month. Get a small car loan — get it co-signed if you have to – and start making that monthly payment on time every month. That proves to the system that you're creditworthy."

Because new information is weighted more heavily in credit scores than old information, you can turn your credit around relatively quickly.

"It will only take four to six months to start impacting your credit in a positive manner," Ferrari says. "And it will just get better and better from there."

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