5 ways to kill your credit scores

The curtain has parted, albeit slightly, on the mystery of how your credit rating is calculated. Find out what these common credit problems can do to your standing.

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One of the questions I'm asked most often about credit scores is exactly how much certain actions affect people's scores.

What good is a good credit score?

Until now, the best I could do was say, "It depends." That's because the company that created the leading credit score, the FICO, has been wary about releasing specifics.

Fortunately, that just changed. At my request and for the first time, the company (also known as FICO) has released details about how specific actions, from maxing out a credit card to filing for bankruptcy, can affect people with different credit scores.

I asked the company to compute the results of those actions for two examples: a person with a 780 score, which is an excellent score on the 300-to-850 FICO scale, and someone with a 680 score. The results:

	Effect on a 680 score	**Effect on a 780 score**
Maxed-out card	-10 to -30	-25 to -45
30-day late payment	-60 to -80	-90 to -110
Debt settlement	-45 to -65	-105 to -125
Foreclosure	-85 to -105	-140 to -160
Bankruptcy	-130 to -150	-220 to -240

Source: FICO

The results are given in a range because FICO is still a little nervous about revealing too much about its proprietary scoring. But the range is fairly tight, and we can clearly see the disparate impacts of the different actions.

A guide, not a guarantee

Before we go further, I have to make this clear: Your mileage may vary. People with the same credit score can have very different credit profiles: more or fewer accounts, a different mix of accounts, a longer or shorter credit history, use of more or less of their available credit, etc.

Because of those differences, the same action -- maxing out a card, say -- can have different effects on people with the same score, depending on the details of their individual credit profiles.

For the sake of this exercise, FICO assumed both people had several active major credit cards as well as a mortgage, a car loan and student loans.

The person with the 780 score:

- Has at least 10 credit accounts in total and a 15-year credit history.
- Uses 15% to 25% of her credit card limits.
- Has no late payments on her credit reports.
- Has no collection accounts or other major negatives.

The person with the 680 score:

- Has six credit accounts and an eight-year credit history.
- Uses 40% to 50% of her credit card limits.
- Was 90 days late on an account two years ago.
- Was 30 days late on another account one year ago.

Here's what you need to know about each action and the effect it had:

1. Maxing out a credit card

Using 100% of your limit on any credit card puts you at risk of over-limit fees. It also takes a bite out of your credit score.

Our person with the 680 score might lose 10 to 30 points from this one action, while the 780 scorer could shed 25 to 45 points.

The difference points up an important fact: The higher your score, the more points you tend to lose from "bad" actions. That's because the scoring formula is sensitive to any sign you're getting in over your head. Maxing out a credit card is considered one of those signs.

You also should know that it typically doesn't matter to the formula if you carry a balance or pay off that maxed-out card as soon as you get your statement. What's usually reported to the credit bureaus is the balance on your last statement. Even if you pay the debt in full before the due date, the maxed-out card will hurt your score.

2. Skipping a payment

Mailing a payment a few days late normally won't hurt your score, although you may incur late fees and trigger higher interest rates. The big hurt comes when you miss a payment cycle entirely.

A 30-day-late report would shave 60 to 80 points from our lower-scoring person and 90 to 110 points from our higher scorer. In other words, one lapse of attention could plunge the 680-scorer into subprime credit territory, and our 780-scorer could find credit much harder to get and more expensive.

This is why it's so important to set up automatic payments to ensure your bills get paid on time, all the time. With credit cards, you can set up automatic payments that take the minimum payment out of your checking account to ward against a late payment. You can always make a second payment that reduces your debt or pays it off entirely. You can sign up for automatic payments on the Web site of your card issuer.

3. Settling a credit card debt

All the advertisements about "settling your debt for pennies on the dollar" make debt settlement sound like a great solution. But failing to pay what you owe a creditor will take a serious toll on your score.

The 680 scorer would lose 45 to 65 points with this maneuver, while the 780 scorer would shed 105 to 125 points.

Our scenario assumed that our borrowers would miss one payment before settling the debt with their credit card companies. In reality, debt settlement negotiations can drag on much longer, with each missed payment taking another chunk out of your score.

Settling a debt with a collection agency would hurt less, probably much less, because the FICO formula is set up to weigh more heavily what the original creditor says about you than what a collection agency reports. But if our borrowers were settling with a collection agency instead, their scores would be lower to begin with, because they would have collection accounts on their records.

Also, you should know that the amount of debt your creditor "forgives" in a debt settlement solution is typically added to your taxable income. So you may save some money by settling a debt, but you'll give some of it back to Uncle Sam in higher taxes.

4. Losing a property to foreclosure

Foreclosure deals a severe blow to your credit score: 85 to 105 points for our person with the 680 score and 140 to 160 points for the one with the 780 score.

Foreclosures have implications for your future ability to get a mortgage as well. Although your score may start to improve as soon as the house is gone, mortgage lenders may not be willing to extend you another home loan until two to four years have elapsed.

In an attempt to protect their credit, many people attempt short sales, selling their houses for less than what's owed, with the lenders' permission. Unfortunately, these transactions, even if successful, are often reported as settlements. And a settlement, as you've seen, is pretty bad for credit scores. To lenders, a short sale isn't quite as bad as a foreclosure, though, and it may be easier to get another mortgage once you've rebuilt your credit.

5. Filing for bankruptcy

FICO spokesman Craig Watts once called bankruptcy the nuclear bomb of credit actions. Filing for bankruptcy would shave 130 to 150 points from the 680 score and 220 to 240 points from the 780 score.

This is different from the other black marks, where the higher scorer was still left with better numbers than the lower scorer. In this case, both would wind up near the bottom of the credit barrel. Getting new credit, particularly in the current credit-crunch environment, would be extremely tough.

Sometimes, of course, bankruptcy is the best of bad options. (See "Quiz: Should you file for bankruptcy?") But if you can't pay your bills, you should at least explore the other possibilities: forbearance, credit counseling or even debt settlement.

Finally, if you have any of these five black marks on your record, remember two things: The impact on your score may differ from what's shown above, and regardless of how many points you lost, you can rebuild your FICO score over time.

You can start by using a free FICO score estimator, such as this one at Bankrate.com, or MSN Money's credit score estimator, which similarly models a score on Experian's 330-to-830 range, to see where you stand.

With paid scores, you'll get specific advice about how to improve your numbers. In general, when you're trying to build a credit score, you should:

- Pay your bills on time, all the time.
- Reduce your credit utilization; below 30% is good, below 10% is better.
- Have a mix of credit on your reports, including installment loans (mortgages, auto loans and personal loans) and revolving accounts (credit cards and lines of credit).
- Refrain from closing accounts.
- Apply for new credit sparingly.