The Score Is Falling! The Score Is Falling!

The Motley Fool
By Dayana Yochim

Ah, the complex world of credit scoring. If only the credit reporting agencies would share their secret formulas.

Dayana, what happened to our credit!? My husband and I moved last summer and just checked our scores for the first time since then. Mine went down 20 points (it's now between 680 and 700, depending on which report I look at) and my husband's went down about 100 points, dropping from the 770 range to between 650 and 720. Other than moving and taking on a smaller mortgage (which we put in both our names instead of just mine), nothing much has changed.

A few specifics:

We carry no balances on our credit cards. I have three late payments noted on one credit card account. The last late payment was three years ago. A 12-year-old credit card (balance paid in full) was cancelled by the lender. I assume they cancelled from years of inactivity, or possibly my neglect of an annual renewal notice. My husband has perfect payment history and no credit card debt except for $7,500 charge for a new moped sitting on a card with a one-year, 0% interest promotion. Both of us have some student loan debt with regular payment history

With our responsible use of credit, I don't understand our scores. Should I try to reopen the old account that was closed? Any ideas on how to fix things?

Best,
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Wait! They do, sort of. In general, we know that past payment history accounts for 35% of your score. The amount of money you owe holds a 30% weight. How long you've been in the system makes up 15% of your final grade. The amount of new credit you apply for affects 10% of your score, and the types of credit (retail accounts, installment loans) has another 10% impact on your overall score. But these are just general guidelines.

So what exactly happened since last summer? Changing addresses has no bearing on your credit score. Nor, despite rumors otherwise, does a change in salary. But there are some things that can monkey with those three magic numbers. Here they are, in no particular order:

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The check isn't yet in the mail. Timing is everything, particularly when it comes to your billing cycle. For example, if you put all of your expenses on a card to earn cash back (groceries, gas, gum, doctor co-pays) and you check your score toward the end of a billing cycle, there will be a larger "debt-to-available-credit" ratio. But you never carry that amount over to the next month, you say. Even if you always pay off your balances in full, the computers don't know if you're going to pay it off this month or run it up even more. So they score you on the numbers they have at that very moment. Maybe the last time you checked your scores you had just paid your bills, and the balances were low or $0.

There's a new IOU. Your husband's history now includes a huge line of credit that was not there before — a mortgage. This could throw his ratio out of whack for a while. To see how he looks to lenders, add up everything he owes and divide it by his overall credit limits: That is his debt-to-available-credit ratio. If it's more than 30%, then his score may be suffering as a result.

Credit agencies don't recognize a deal when they see it. The $7,500 moped is reported as a debt, no matter what sweet 0% APR deal you're using to pay it off. Paying off the balance could bump up his score, but why spend money you don't have to until it's time? Even if there are no payments due, he should make the bare minimum payments — on time, every month — just so that account is current and he is providing positive credit information for the lender to report.

Youth isn't always an advantage. Depending on your age, you may have what lenders consider a "thin" credit file. If you and your husband are in your 20s, you probably don't have a long credit history, so small movements of money can have a bigger impact. As far as re-opening an old account, you cannot re-activate an account that has already been closed. Opening one now with the credit union will simply be treated as a new account and new line of credit. But your thinking is good: Keep your oldest account open, and use it occasionally to keep it active. Lenders like to see that history.

Past credit bloopers are still haunting you. Don't discount the impact of late payments. True, they matter less over time, and will drop from your report after seven years. (Here's more reading on how fast credit notations "expire.") But if there is limited information on your report (e.g. lenders not reporting your payment info or a lot of dormant cards), the late notations will loom larger.

What happens to your credit score when you max out or miss a payment, or even pay your balance in full? I consulted the FICO Score Simulator to find out.

Scenario 1: You pay all your bills on time every month. Paying on time can up your score significantly. Just doing so for one month can take your score from 707 to 727. According to FICO, more than 68% of the U.S. population did not miss a single credit payment in the recent past. In other words, it pays to be punctual.

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Scenario 2: You space out and forget to pay all your bills every month. Watch your score go from 707 down to as much as 582. If you tend to be forgetful, you may want to set up automatic bill pay — at least for your credit cards and other loans. Nearly one-third of the borrowing public has evidence of serious delinquency information reported on their credit file.

Scenario 3: Feeling generous, you pay down about one-third of your outstanding balances. Sorry, that's not going to have as big of an impact as you might think. Your score will hover in the 707 to 727 range. The national average of the total amount owed on non-mortgage-related credit obligations by U.S. consumers is around $11,000. Still, that doesn't factor in the exorbitant interest being paid for the borrowing privilege.

Scenario 4: You go on a spending bender and max out all your cards. That'll hit you where it counts — in your wallet and in your credit score, which could dip down into the 630s.

Scenario 5: You apply for and receive a $3,000 line of credit. All other factors being "normal," this won't affect your score too much (it'll fall somewhere between 697 and 717). For the average consumer, the most recent account opening was 20 months ago.

Scenario 6: You transfer a $5,000 balance to a lower-interest card. Good for you, if you're doing so to pay off your debt more quickly. In the long term, this move will pay off in spades. In the eyes of lenders, it doesn't much matter, though, since you still owe the same amount of money, regardless of what account you moved it to. In this case, your score will be anywhere from 692 to 722.

Playing "let's pretend" is a fun exercise, but the wait-and-see game may be a better use of your time. Since you and your husband have already gotten your mortgage and have locked in your student loans and that 0% deal for the moped, I wouldn't fret too much about your scores bouncing around a bit. Ultimately, shoot for scores above 720, which will make you eligible for good loan rates.

Unless you need to apply for more credit, refinance your home, or make some other maneuver where your credit score matters, don't sweat it.

Dayana Yochim's credit score ranges from 785 to 810, depending on who's reporting. She was happy to discover that her broker consulted the latter when she was shopping for mortgage rates. The Motley Fool's disclosure policy has a FICO score of 826.