The Real Impact of Late Payments

The Motley Fool

By Dayana Yochim

It has long been understood that if you pay your bills late, your credit score will suffer.

Well, it turns out that's not entirely true. Yes, payment punctuality counts for about 35% of your overall credit score. And, yes, creditors get antsy when customers start slacking on sending in their checks. But according to credit industry insiders, lenders give consumers a bit more leeway than you might think.

As it turns out, the method that lenders use to calculate the impact of late payments is less like a strict scorecard and more like the honor system.

Credit courtships

Consumer credit scores are the industry's way of playing the odds. When a lender consults your credit score, it wants to know whether it's going to lose money by doing business with you. The inputs—payment history, amounts owed, length of credit history, amount of new credit, types of credit—are key behavior that helps banks gauge your financial personality. Based on this information, the system spits out an overall credit score. (This is the "permanent record" that you were warned about as a kid.)

More than anything, your credit score is like the lender's crystal ball. It's not simply a reflection of what kind of customer you've been in the past, but a guess at the likelihood that you'll be the same kind of customer in the future.

Like anyone sizing up a potential relationship, lenders are willing to let some things slide—at least for a while. According to John Ulzheimer, former Equifax and Fair Isaac credit expert, and Emily Davidson of Credit.com (check out the site's robust learning center), the credit industry isn't overly judgmental about the occasional late payment—specifically ones that are 30 and 60 days late.

That's not to say that your late payment will have no ill effects on your overall credit score. A payment that's late 30 or 60 days once a year, say, will temporarily ding your credit score for the time period it is reported as currently past due. But once the payment is made, your credit score will recover.

Think of it as being like the forgiving blush of new love. Rarely does someone say "game over" when a new love runs 15 minutes late for a date. But the second and third and fourth time—particularly if it's the second, third, and fourth date in a row—you show up after your date's lip gloss has already worn off, and you've got some explaining to do.

Continued on back

When the relationship sours

There is one thing that credit card companies, mortgage lenders, landlords, employers, insurers, and utility companies have in common: All of their scoring systems are calibrated to suss out borrowers who may pay at least 90 days late (or worse) in the 24 months after their score is calculated. In the eyes of creditors, these consumers are the biggest credit risk.

Don't underestimate their aversion. A single three-month late payment on your report will cause long-term damage to your credit score. This ding can linger on your record for as long as seven years. In fact, according to Credit.com, a single 90-day late payment is as damaging as a bankruptcy filing, a tax lien, a collection, a judgment, or a repossession.

It doesn't matter if you're late paying a $50 bill or a $5,000 one—all that matters is that you were 90 days behind in paying your due balance. This is the creditor's equivalent of "I don't care if we were just going to McDonald's for dinner—you were 30 minutes late!" (Here's how long other slipups will continue to haunt you.)

The difference between 30- and 60-day late payments and one that is reported as 90 days past due is that the latter will continue to be reported, whereas the two former will drop off once the bill has been settled. Once you've passed that threshold a single time, the credit reporting industry assumes you are much more likely to do it again and therefore keeps the red flag waving. The only exception is if you are a habitual 30- and 60-day late payer. Then—all together now—*that will go on your permanent record.*

What about the bill that was forgotten for four months or longer? The report of a 120-day-plus late payment does no more damage to your overall credit score than the 90-day missed payment does. However, by this time, your account has likely been "charged off," moved to an internal collections department, or sold to a third-party collection agency. It's these two actions that will cause further credit score damage.

Even if you settle the debt with the lender for an amount less than what was due, the fact that the debt was not covered entirely will continue to be reported. Same with repossessions or foreclosures. These events indicate that the consumer did not fulfill his or her contractual obligation with the lender and will be reported as a serious delinquency for up to seven years. Even tax liens can have a serious impact on consumer credit scores—so much so that even after the lien is paid or released, the credit score is still damaged.

Make your mea culpas

You can't erase a 90-day late payment if it's true. But you should make sure that everything reported about it—the dates, lender, resolution—are accurate.

Continued

If you haven't already gotten your free credit reports from each of the major credit reporting agencies, do so. (Here's how.) If your lender is badmouthing you out of turn, you have the right to dispute the item with both the reporting lender and the credit reporting agency. If the item is removed from your report permanently (not just when it is being investigated), you'll see an immediate uptick in your score.

Even if you get **Citibank** (NYSE: C) to agree that it was mistaken in reporting a late payment last year and convince **Capital One** (NYSE: COF) that it's some other John Smith that's behind on his bills, this new insight into consumer credit scoring isn't an excuse to suddenly become a slacker.

No matter what, if you pay your bills late, your credit will suffer. It's just that the rare minor flub won't leave a permanent scar.

This feature may not be reproduced or distributed electronically, in print or otherwise without the written permission of uclick and Universal Press Syndicate