

How to Recover From a Credit Disaster

When financial obligations exceed your ability to manage them, it can lead to a personal crisis like [bankruptcy](#), [foreclosure](#) or simply bad credit. Here's how to rebuild your credit standing and regain control of household finances.

1. Build an emergency fund

Unanticipated expenses often overwhelm us. Build an emergency fund — before you need it — with at least 3 to 6 months' worth of living expenses to get you through temporary loss of income or sudden bills.

2. Manage credit card debt

High-interest credit cards get a lot of people in trouble. If you have existing credit card debt:

- Establish a monthly routine of paying it down.
- Make more than the minimum payments.
- Avoid late payments at all costs.
- Don't take on more debt.
- Don't max out your credit card(s).
- Pay for most things with cash.
- Don't get more cards.
- Don't close out cards you've paid off; this could damage your credit by increasing your [debt-to-credit limit ratio](#). If you have an excessive number of cards, close some but keep the oldest ones; a [longer credit history](#) helps your credit score.
- Keep the cards at home to avoid using them.

3. Re-establish good credit

Although it seems contradictory with #2 above, to rebuild your credit history you need to show lenders you can borrow money and repay it responsibly. If you're starting from scratch, get a [secured \(prepaid\) credit card](#) where the amount you deposit with the card issuer represents your credit limit. After a period of on-time payments, you can probably transition to an unsecured one.

4. Practice thrift

If you don't fundamentally change your spending habits, you may gradually relapse into debt. Live within your means.

- Achieve financial goals by setting measurable targets, and track your progress monthly.
- Save a portion of every paycheck with automatic deposits.
- Don't mortgage your future for today by borrowing against your home equity.
- Save your next pay raise.
- [Buy what you need](#), and use what you buy (e.g., the clothes in your closet and the food in your fridge).
- Follow a [budget](#).

5. Review your credit report.

See where you stand by [checking your credit report](#) and [score](#) once or twice a year. Seeing even small improvements can motivate you to continue on the road to smart money management.