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How To Bounce Back From Bankruptcy

Establish a record of paying back debts reliably

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More than one million Americans filed for personal bankruptcy last year—an increase of more than 30% over 2007. Unexpected medical bills are a top cause of personal bankruptcy. Other reasons include losing a job, struggling through divorce, getting stuck with an unmanageable mortgage, or simply going on a $30,000 credit-card spree. While a bankruptcy will remain on your credit record for up to 10 years, you can still bounce back and reestablish a good credit rating. So if bad circumstances—or tough decisions—have led you to file, don't despair. In a best-case scenario, after having your debts discharged by a court, you could qualify for a car loan with good rates in a year and a mortgage in two to four years.

According to attorneys and consumer advocates, the path back usually involves careful steps to reestablish creditworthiness. Here's what to do.

1. Start with one credit card. Get a card with the lowest possible fees and accept a spending limit as low as $250. Consider a "secured" card, which allows the bank to make deductions from a savings account if you don't pay what you owe. Some lenders hawk cards with 29% rates and $49 application fees, so use sites like Bankrate.com to hunt for better terms. Make sure that the card issuer will report your new payment history to the three main credit-rating agencies so you can establish a record of paying back debts reliably.

Even after you file for bankruptcy, card issuers will be jockeying for your business. "You're a good credit risk," says Alan Pressman, a bankruptcy attorney in Islandia, N.Y. "You have no debt, and they know you can't file again for bankruptcy protection for as much as eight years."

2. Make prompt payments 100% of the time. "A single late payment can set you back by six months to a year," says Evan Hendricks, author of Credit Scores & Credit Reports. "It can undo all your hard work and drop your credit rating by 40 to 90 points." In contrast, paying off debt quickly not only rebuilds your creditworthiness, it also helps you avoid steep interest charges.

3. Ask for lower rates, especially as your credit improves. "You have to be patient," says attorney Nicholas Gebelt of Whittier, Calif. "It's going to take about a year of good payment history, but gradually the rates will come down." Some lenders make these adjustments automatically. Even so, it never hurts to treat credit terms as negotiable and to shop around when necessary.

4. Avoid "credit-repair" schemes. Some services assert that they can fix bad credit in two weeks or less, for a fee. These outfits bombard credit-scoring agencies with claims that various defaults and late payments didn't happen. That can cause your delinquencies to be delisted temporarily, but they can ultimately be added back to your credit report.

5. View a car loan as the next big step. While car dealers typically want to see at least a year of good payment history before financing a post-bankruptcy buyer, some dealers aren't picky these days. Initial rates can be as high as 22%, but reliable payers can refinance at better terms later on. Opting for a used car can keep costs down.

6. Keep balances under control. Post-bankruptcy borrowers who seem to be handling new debt well will find that their credit limits increase rapidly. That's gratifying but dangerous, says Ira Rheingold, executive director of the National Association of Consumer Advocates in Washington, D.C. "Keep low limits on your cards and live within your means," he advises.

7. Plan for a mortgage. Some of the biggest home-loan programs won't consider borrowers who have filed for bankruptcy in the previous four years. Loans guaranteed by the Federal Housing Administration often provide the fastest path back to home ownership, usually with a two-year wait after bankruptcy. Banks trying to sell foreclosed properties may also be more flexible.