Help Advise Clients on the Credit Consequences of a Short sale Versus Foreclosure

By Jen Lenz

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Our credit score controls every part of our financial life. Good credit is not only social status, but it also has power to slash interest rates on credit cards and loans taken, including greater ease in borrowing money from the start.

Distressed homeowners, struggling to pay the mortgage on an upside down property, may find themselves deciding between the value of their credit score and everyday living expenses, such as groceries, utility bills, and clothes. Living day to day is not a solution. They must decide the value of a credit rating in comparison to personal circumstances and plan a path out of their overleveraged home. In this way, if they decide to stop paying the mortgage in order to pay other bills or to save to move to a new location, any damage to their credit rating will have been weighed against the needs of their financial future and therefore has value.

Credit is potentially damaged by the seller in two ways during a short sale. First, credit is damaged by the number of months delinquent. Accounts are considered delinquent when they are outstanding by thirty days. Thirty days late will drop a credit score 40- 110 points; ninety days late will drop a score 70- 130 points.[4] Any delinquent accounts with creditors show up on a credit report and reduce the overall score. So when the mortgage payment goes past thirty days due, the bank will report that to the credit bureaus and the damage starts. Each additional delinquent month adds continuing negative reporting to the credit bureaus. This reporting has a cumulative effect.

The second way their credit is affected is how the bank reports the mortgage loan to the credit bureaus when the account is finally closed after the short sale. In most cases, the account will show on their credit report as: *account closed, settled for less than full value*. If the account has not gone over 59 days delinquent before the short sale[4], this can reduce a credit score by as little as 50 pts. Compare this to a foreclosure which can damage a credit report reducing a score by 250 or 300 points. Credit scores and reporting are not an exact process. Some experts are informing clients that a short sale or a foreclosure will affect the score the same, as creditors now view short sales as debt forgiveness, thus initially damaging the credit score in a similar way[1.] However, many variables affect an overall score. If homeowners, who chose to short sale, continue to pay their other bills, their credit should not be severely damaged for the long term. Real estate expert, attorney, and author of <u>My Short Sale Guru's Guide to Healing and Financial Recovery for Discouraged Homeowners</u>, Renee Marie Smith agrees with the latter. "In the 5 years that I have been working with short sale clients, the number one issue has been credit.

Each client reviews the short sale's impact on their credit and weighs that against proceeding with the short sale or other alternatives like bankruptcy. The short sale wins hands down as the best option in terms of creating the least amount of damage and allowing for the greatest ease of recovery."

Fannie Mae estimates puts the ability to purchase a new home at about two to three years post short sale, if the buyer has steady income and has consistently made other debt payments.[3] Other factors affect the possibility of acquiring a mortgage, like the amount of money available for down-payment and the circumstances surrounding the short sale.[3] For more information you can visit the government website http://www.ftc.gov/bcp/menus/consumer/credit/rights.shtm or for general information on credit reports http://www.alcovamortgage.com/credit/index.shtml

Many short sales have achieved the homeowners' credit goals. What is needed first is to decide what was best for them. Perhaps their credit score is the most important issue at hand. In some cases, an entire short sale can be processed before the seller did goes past ninety days delinquent in their mortgage payments. Closing this quickly causes very little credit damage, which can be the main goal. But this requires, but is not solely reliant upon, an approved offer on the property, a suitable buyer, coordination with the bank, and timely submission of complete and accurate documents.

In other cases, alternative costs make take precedent. Compare the previous scenario to a homeowner who decides instead to save the money he would have spent on the mortgage in order to move his family to a new home. With this choice, much more damage will be done to the individual's credit rating, however, it will be done as part of a relocation plan; a cost to reach a goal.

You can help homeowners decide which option is right for them and the amount of time they will need to create the resources to reach this goal. Continue to inform them that there are other options to foreclosure; options which can be far less damaging.
In the long run, compared to foreclosure, a short sale does less damage to your credit. Such as:

- If you short sale your home, you may be eligible to for a new home purchase with a Fannie Mae backed loan within two years of a short sale on your primary residence versus foreclosure on your primary residence, you are not eligible to apply for five to seven years.[3]
- It is not required that short sales are disclosed to future banks; versus, a foreclosure must be disclosed on the 1003 form at time of loan application. Foreclosure is considered a valid reason to be declined.[2]

- Short sales are not a negative for employers versus a foreclosure which may impact anyone seeking security clearance, may be considered a negative for future employers on a job application, or may be a cause for termination with current employers, as similar to a bankruptcy.[2]
- In a foreclosure, mortgage lenders can pursue the homeowner for the shortfall in the delinquency judgment. A foreclosure judgment may last for twenty years and can be renewed for another twenty.[2]

1 Bright, Paul eHow.com http://www.ehow.com/how-does_4602331_short-sale-effect-credit-rating.html#ixzz1j04kM3wG Does a Short Sale Effect a Credit Rating?

2 Smith, Renee Marie My Short Sale Guru's Guide to Healing and Financial Recovery for the Distressed Homeowner www.smithtitleservices.com

3 Weintraub, Elizabeth http://homebuying.about.com/od/foreclosures/f/071008_BuyAgain.htm How Soon Can We Buy a Home After a Foreclosure or Short Sale?

4 Weintraub, Elizabeth http://homebuying.about.com/od/4closureshortsales/qt/060907SScredit.htm Short Sale and Foreclosure Effects on Credit