Short Sale and Foreclosure Effects on Credit

The Impact of Short Sales/Foreclosures on Credit Reports

Sellers may wonder whether letting a property go into foreclosure would be easier and smarter than going through a short sale. With a foreclosure, and depending on state laws regarding foreclosure, a seller could stay in the property, essentially rent free, for four months to a year before being forced to vacate. But that fact alone does not mean a foreclosure is better.

A short sale involves offering the home for sale, generally listed through MLS. Potential home buyers will make appointments to view the home, some will make lowball offers, agents might hold open houses and, in general, a seller's life will be disrupted, all in the hopes that a buyer will buy the home.

Basics of a Short Sale

Short sales happen when a lender agrees to accept less than the amount owed against the home because there is not enough equity to sell and pay all costs of sale. Not all lenders will negotiate a short sale, and that is why a real estate agent or a lawyer can be a tremendous help by contacting the lender's loss mitigation department to find out.

You can't just wake up one morning and decide you're going to sell your home at a loss by asking for a short sale. It used to be that lenders wouldn't even consider a short sale if your payments are current, but that is changing. However, realize that lenders will be more agreeable to negotiation if your payments are in arrears. Plus, if you have cash assets, the lender might try to tap those accounts. Doing a short sale is not for the faint of heart.

How is the Seller's Credit Affected?

According to David Steep, division manager at Vitek Mortgage, sellers will take as big a hit on their credit report by going through foreclosure as giving the lender a deed-in-lieu of foreclosure. Steep says the points lost on a FICO score are as follows:

- **Foreclosure or Deed-in-Lieu of Foreclosure**
  Both of these solutions affect credit the same. Sellers will take a hit of 200 to 300 points, depending on overall condition of credit. This means if a seller's FICO score before foreclosure was 680, it could dip as low as 380.

- **Short Sale**
  The effect of a short sale on a seller's credit report is identical to that of a foreclosure. The ding on credit will show up as a pre-foreclosure in redemption status, Steep says, which will result in a loss of 200 to 300 points. This means a short sale with a previous FICO of 720 will see it fall from 520 to 420.

  Catherine Coy, a mortgage broker in southern California, agrees. "The effect on a consumer's credit report — foreclosure vs. short sale — is the difference between being hit by a train or a bus," says Coy.

Waiting Period Before Buying Another Home

- **Foreclosure or Deed-in-Lieu of Foreclosure**
  Steep says a seller who wants to buy another home after foreclosure will end up waiting about 24 to 72 months before a lender will offer any kind of interest rate that makes sense.

  Coy says, "The good news is a short sale will allow the consumer to obtain an institutional loan for a new home within two years".

- **Short Sale**
  Some agents say the good news for short sale sellers is the wait is much shorter before buying another home, and new Fannie Mae guidelines make that a true statement.

  Can a seller buy again under two years? Partially true, says Coy, "It's an utter myth that a consumer 'can buy again in about 18 months at a good interest rate.' However, new Fannie Mae guidelines now require only 24 months' seasoning, and that's good news for agents who specialize in short sales."

Short Sale/Foreclosure Deficiency Judgments

The bad news is a seller could be subject to a deficiency judgment for the difference between the loan amount and the amount paid. In California, purchase money loans are not subject to deficiency judgments; however, hard money loans, equity loans and refinances are. Some other states have laws regarding personal guarantees, which could also result in a deficiency judgment, if the home owner is held personally liable for loan repayment.

The lender has sole discretion whether to pursue a deficiency judgment in those instances when the judgment is permitted. To determine whether a pending foreclosure or short sale is subject to a deficiency judgment, talk to a real estate lawyer.

If you're a seller trying to decide whether to let a home go through foreclosure versus attempting a short sale, salvaging your credit may not be an advantage to doing a short sale. Coy says that according to "Score Factor Code #22, there's no credit score advantage to a short sale over a foreclosure." The only advantage is being able to buy another home within two years over the three- to five-year period required for foreclosures. But seek legal and tax advice before making that decision.

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