

SHORT SALE & FORECLOSURE

Effects on Credit

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 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. Typically, lenders won't even consider a Short Sale if your payments are current. 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 Christopher Rockey, Director of Education for Mortgage Resolution Services, sellers will take a bigger hit on their credit report by going through foreclosure or giving the lender a deed-in-lieu of foreclosure. Rockey says the points lost on a FICO score (the formula used to assess a borrower's risk factor) are as follows:

- Foreclosure or Deed-in-Lieu of Foreclosure:
Both of these solutions affect credit the same. Sellers will take a hit of 250 to 280 points. This means if a seller's FICO score before foreclosure is 680, it could dip as low as 400.
- Short Sale:
The affect of a short sale on a seller's credit report is much less damaging. The ding on credit will show up as a pre-foreclosure in redemption status, Rockey says, which will result in a loss of 80 to 100 points. This means a Short Sale with a previous FICO of 680 will see it fall to 480 to 600.
- Important Note:
Borrowers must realize these numbers are only theory. They must continue to be responsible with their other consumer debt. Often if the hardship is financially related, borrowers fall behind on other consumer responsibilities.



Waiting Period Before Buying Another Home

- Foreclosure or Deed-in-Lieu of Foreclosure:
Recently Rockey said, Fannie Mae and Freddie Mac have changed their guidelines. Foreclosure is a minimum of 5 years with a FICO score of 680 and 10% down. A Deed-In-Lieu is 4 years, 680 FICO, and 10% down.
- Short Sale
2 years, no minimum credit score and no minimum down payment. These numbers are extremely important to consider.

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 Arizona, purchase money loans are not subject to deficiency judgments; however, hard money loans, home equity loans and refinances are. Exception: refinances can be anti-deficiency if paying off purchase money loans.

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, clarify the issue with the lender or talk to a real estate lawyer.

For sellers trying to decide whether to let a home go through foreclosure versus attempting a Short Sale, salvaging their credit is the main advantage to doing a Short Sale. Be sure to seek legal and tax advice before making this decision.

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