Foreclosure: Effect on Credit Rating

A foreclosure has a significant negative impact on the homeowner's credit rating, the effects of which will endure for at least seven years. There is no legitimate means of erasing a foreclosure from the individual's credit rating until the full seven years have elapsed.[4] It is estimated that the foreclosure will result in a reduced credit rating of 200 - 300 points, depending on overall condition of credit. This means if a FICO score of 680 before foreclosure could dip as low as 380.[5] Also, where a deficiency judgment is awarded to the lender, the borrower's credit rating will be affected until the judgment is satisfied. *See* below.

Deficiency Judgments

Where a home is sold for less than what is owed on the mortgage, there is the potential that the borrower will be liable for the deficient amount. In the case of virtually all Florida foreclosures,[6] the lender is entitled to petition for a deficiency judgment if the sale of the home does not cover the balance due on the mortgage. Since foreclosure in Florida is a judicial process, the lender is already obligated to pay attorney fees and court costs. As a result, the lender may choose to request a deficiency judgment unless the discrepancy is relatively minimal.

In the case of a short sale, the matter is not as clear. Whether the lender is entitled to a deficiency judgment may depend upon the terms negotiated with the borrower. In some cases, the lender will waive its right to a deficiency judgment in exchange for the borrower's cooperation. If the lender does not waive this entitlement, whether it seeks a deficiency judgment or not will be a business decision based on the amount of the deficiency, costs of litigation, etc.

Because state laws vary and each homeowner's circumstances are different, it is important that homeowners in distress consult a mortgage broker they trust and a local real estate attorney.

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[4] That is not to say that a skillful credit repair firm could not erase the mark by illegitimate means.
[5] According to David Steep, division manager at Vitek Mortgage.
[6] The only exception is where the mortgage is "non-recourse." Most mortgages do not fall in this category and there would have to be specific language in the mortgage or promissory note indicating the debt in non-recourse in order to raise this argument.