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ON THE WEB

## THE NATION'S HOUSING

# Delinquency and Credit Scores

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**W**hen you do a short sale of a house, or modify the mortgage, is there much of an effect on your credit score? What if you walk away from the mortgage altogether?

A scoring company created by the three national credit bureaus — Equifax, Experian and TransUnion — has some eye-opening numbers. VantageScore Solutions, whose risk-prediction scores are being used by some of the largest mortgage companies and banks, has found that the way consumers handle their mortgage problems can have profound effects on their credit scores.

Some alternatives — such as loan modifications that roll late payments and penalties into the principal debt owed on the house — can actually increase borrowers' scores modestly. Refinancings of underwater, or negative-equity, mortgages — such as those targeted by the Obama administration's Making Home Affordable program — may have little or no negative impact on scores, even though the homeowners might have been tottering on the edge of serious delinquency before refinancing.

The Vantage score, the primary competitor to the long-dominant FICO score, rates borrowers on a scale ranging from 501 (subprime, highest risk) to 990 (super-prime, lowest risk). Unlike FICO, where scores can vary by 50 to 100 points based on which bureau supplied the underlying credit data, Vantage scores are about the same for each consumer.

When homeowners negotiate a short sale with lenders, they sometimes assume that there will be relatively little impact on their

scores. After all, the loan was successfully paid off, there was no foreclosure and the lender agreed to accept a lower balance than was owed.

But in fact, according to VantageScore researchers, short sales can trigger big drops in credit scores. Sarah Davies, senior vice president of analytics, said a homeowner who previously had an excellent score of 862 might see the score plummet 120 to 130 points immediately as the result of a short sale.

While it's true that the lender may lose less money through a short sale than in a foreclosure, Davies said in an interview, "it's still a derogatory event." The full debt was not repaid. The lender lost money. The score tanked.

What happens when borrowers walk away from their mortgage debts altogether — the so-called "strategic defaults" that have become commonplace in some large markets, especially in California? They can count on immediate hits to their scores of 140 to 150 points, plus negative marks on their credit bureau files for up to seven years.

People who file for bankruptcy protection covering all their debts — mortgage, credit cards, auto loans, etc. — typically get hit with declines of 355 to 365 points — the scoring equivalent of a nuclear bomb. Bankruptcies remain on borrowers' credit bureau files for 10 years.

With all of the mortgage delinquencies, short sales and foreclosures experienced by American consumers in the past few years, has there been a deterioration of average scores across the board? Absolutely.

For example, roughly 36.6 million of the 213 million consumers tracked by the three national credit bureaus in the first quarter of

2008 had Vantage scores above 900 — the super-prime credit rung. That select group represented 17.2 percent of the country's consumers. But by the end of the second quarter of this year, just 15.4 percent — 33.3 million out of 216.9 million — were left among the elite. By credit industry standards, that's a huge shift.

More Americans' scores are slipping into the worst credit category, as well. In the third quarter of 2006, 34.4 million consumers were in the lowest segment — 16.6 percent of 206.9 million people. But by the second quarter of this year, 18.3 percent of all files were in that category — 39.8 million consumers out of 216.9 million.

Most of these changes — fewer people with excellent credit, more people in the lowest brackets — have been caused by late payments on home mortgages, serious delinquencies, short sales and foreclosures, according to VantageScore researchers.

But the bottom-line good news about scores is that homeowners facing financial stress can experience minimal dings to their credit if they contact their loan servicer or lender early in the game — when they first discover that they may have trouble making their monthly payments — and take the first steps toward a loan modification or refinancing.

"Start that conversation early," said Barrett Burns, a former lender and now chief executive of VantageScore. If you wait and fall several payments behind before seeking a modification, "you can lose 240 points on your score" and damage your ability to obtain credit — on anything — for years.

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