# Mortgage problems are Walloping Americans' credit scores

Late payments, delinquencies, short sales and foreclosures are on the rise -- and so are the number of borrowers seeing their credit scores plummet, according to scoring company VantageScore Solutions
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Reporting from Washington - When 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 now 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.

For example, 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, negative-equity mortgages -- which the Obama administration's Making Home Affordable program offers through government-controlled Fannie Mae and Freddie Mac -- may have little or no negative effect on scores, even though the homeowners might have been tottering on the edge of serious delinquency before refinancing.

The Vantage credit score, the primary competitor to the long-dominant FICO credit score, rates borrowers on a scale range of 501 (subprime, the highest risk) to 990 (super-prime, the lowest risk). Unlike Fair Isaac Corp.'s FICO scoring system, whose 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 effect on their scores. After all, the loan was successfully paid off, there was no foreclosure, and the lender voluntarily agreed to accept a lower balance than was owed.

But according to VantageScore researchers, short sales can trigger big drops in credit scores. Sarah Davies, senior vice president of analytics, said a homeowner with an excellent score of 862 might plummet 120 to 130 points after a short sale.

Although it's true the lender may lose less money through a short sale compared with a foreclosure, "it's still a derogatory event," Davies said. The full debt was not repaid and the lender lost money.

What happens when borrowers walk away from their mortgage debts altogether -- the so-called strategic defaults that have become commonplace in some large markets such as in California? They should expect 140- to 150-point hits to their scores, plus negative marks on their credit bureau files for as long as seven years.

People who file for bankruptcy protection covering all their debts (mortgage, credit cards, auto loans, etc.) will get hit with an average 355- to 365-point drop in their scores. Bankruptcies remain on borrowers' credit bureau files for 10 years.

With all the mortgage delinquencies, short sales and foreclosures experienced by U.S. consumers in the last couple of 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 ring. That select group represented 17.2% of the country's consumers. But by the end of the second quarter of this year, just 15.4% -- 33.3 million out of 216.9 million individuals' files -- were left among the elite. By credit industry standards, that's huge.

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% of 206.9 million individuals. But by the second quarter of this year, 18.3% 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 for years.

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