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Protecting Your Credit – Bankruptcy v. Foreclosure

It is an unfortunate but all-too-common scenario today: you bought a home a few years ago during the height of the housing boom. In order to afford for the rapidly price-appreciating home, you took out a risky adjustable-rate mortgage (ARM), think you'd be able to refinance before the interest rate and payments reset. Now that the housing market has slowed and slumped, you find yourself unable to keep up with higher monthly payments and unable to find financing for a new loan. Because the housing market is flooded with excess inventory already, you are unable to sell your home to remedy the situation. You are now faced with a difficult decision: continue missing mortgage payments and lose your house, or file for bankruptcy?

When it comes to your credit score, both of these choices are doozies! Either one will probably cripple your credit for several years to come. The choice may come down to your future goals. A bankruptcy will clear you of your debts to your creditors but it will stay on your credit record for 10 years. In some cases you may be able to keep your house even when you file for bankruptcy, depending on certain circumstances. One requirement is that you are able to keep up the payments on the house, which you may be able to do after your other debts are dissolved.

Losing your home in foreclosure proceedings is a strike that will stay on your credit record for 7 years. Yet this may be an even harsher blow to your credit as it is recorded twice, once as a trade entry and once as a legal entry, both lasting for seven years. When it comes to buying a home again, foreclosure may be a more difficult obstacle to overcome than a bankruptcy would be. Mortgage lenders view both as severe risk indicators, but a foreclosure shows very obviously that you have reneged on a home loan before, causing lenders to worry that you are much more likely to do so again if times get tough. Most will probably consider a foreclosure on your record riskier than a bankruptcy. Either way, though, you will likely have to wait a several years after the event before qualifying for a mortgage loan again.

The best way to protect your credit, of course, is to avoid either course of action. Because so many people are facing foreclosure and bankruptcy today, lenders and creditors are more willing than every to work with debtors. Talk with your mortgage lender and your other creditors. Explain your situation and let them know you are serious about repaying your debts. Your creditors may be able to modify your payment plans to allow for a slower repayment and your lender may even be able to help you refinance into a more affordable loan, or he may simply lower the interest rate on your mortgage. Invariably creditors would rather get something back rather than nothing. Make sure you explore all avenues of compromise before headed for the credit nosedive of foreclosure or bankruptcy.