

Loan Modifications

What you don't know could hurt you.

What exactly is a “loan modification”?

It is a *temporary modification* of your loan terms. The interest rate is adjusted to create a more affordable, lower payment amount for a set period of time, and extends the life of the loan. It does not reduce any of the principal, and the lender is not forgiving any of the debt. It simply creates a lower payment temporarily so the borrower can have time to get back on their feet. The period of time is determined by the lender after the lender gathers information about the borrower's financial and personal situation. Once this period of time is complete, the loan returns to the original terms.

Let's clear up one myth about a modification: it is not necessary to be thirty days behind on your loan payment in order to qualify for a loan modification. The federal government's "Making Home Affordable" plan clearly states that "responsible borrowers who are struggling to remain current on their mortgage payments are eligible if they are at risk of imminent default." This would include borrowers who are upside down on their mortgage or borrowers whose mortgage interest rate has reset and they can no longer afford the payment.

In some cases having a thirty day late payment could actually *work against you*. If you are looking to refinance your home (attain a new, better loan, rather than modify your existing loan), the federal government's FAQ's state that "borrowers who are currently delinquent or have been thirty days overdue more than once during the past 12 months will not qualify". They may still qualify for a loan modification of their existing loan, but not for a refinance (new loan).

Aside from failing to qualify for a new loan that could have much better terms, a thirty day late payment can also cause severe damage to your credit score. A thirty day late may drop your score 100 points or more.

How does a loan modification affect your credit score?

It is always best to negotiate how a loan modification will appear on your credit report. This means that when speaking to your lender, be sure to ask them to report your loan modification in the most favorable way they can. In most cases they are going to report it as "Partial Payment Plan", which is going to have a negative effect. The effect will depend on the rest of your credit report. If there are already issues on the report, such as late payments, maxed out credit cards, and a low score, then it will not effect the score dramatically. However, if the borrower has high credit scores, then a loan modification can drop those scores drastically. A loan modification will have less of an impact than a foreclosure, but it will still have a negative impact.

A loan modification usually costs less for the lender than a foreclosure, so if you are in danger of a foreclosure, contact your lender about a loan modification. It is to their benefit (and yours) to avoid a foreclosure. A word of warning: if you are considering a loan modification, *always go through your lender*. Independent companies will offer to help you get a loan modification and there is usually an upfront fee involved. *This is a red flag*, and these companies should be avoided. *You could lose hundreds of dollars*

and have no results. At worst, you could end up losing your home and completely ruining your credit rating.

You may wonder why a borrower is penalized for trying to continue to make mortgage payments. Under President Obama's plan, there will most likely be more of these modifications done by lenders. If lenders are going to continue to report loan modifications as being in a repayment plan, then Fair Isaac (company that determines credit scores) should look at how this verbiage is coded so that it does not have such a negative affect on a borrower. According to Fair Isaac, "FICO might study whether penalizing borrowers for such loan adjustments is valid as more changes are completed under the Obama administration's housing plan".

Until changes are made, consumers should do their best to stay informed. Here are three key aspects to look for when considering a loan modification:

- 1.) Know the exact terms of the loan modification
- 2.) Is the loan modification through the government program or through the lenders own program?
- 3.) How will the loan modification be reported to the credit reporting agencies?

Take your time, read the fine print, and if possible have an attorney review any paperwork before it is signed. A loan modification can be a very good program for some people, just know your options and proceed carefully.

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