

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

[See a sample reprint in PDF format.](#)

[Order a reprint of this article now](#)

THE WALL STREET JOURNAL

WSJ.com

LOANS & CREDIT | OCTOBER 20, 2009, 9:07 P.M. ET

Digging Yourself Out of a Mortgage Mess

By JANE J. KIM AND M.P. MCQUEEN

Homeowners struggling to save their houses could inadvertently trash their credit scores.

This year, the Obama administration began pushing so-called loan modifications as a way to keep millions of Americans in their homes as real-estate values plunged and unemployment soared. Under the government's Home Affordable Modification Program, or HAMP, the lender agrees to adjust the terms of the loan, in most cases by temporarily lowering the interest rate or extending the period in which the loan must be repaid, both of which serve to lower the monthly payment. Mortgage companies also have their own programs for borrowers who don't qualify for the government program.

Generally, loan mods are designed for homeowners who are currently experiencing financial distress or are at imminent risk of default. You don't have to be behind on your payments in order to qualify, although many are. Borrowers who enter the program could, for example, be in an adjustable-rate mortgage or an interest-only mortgage and may struggle to keep current on payments when their rates reset.

Yet many homeowners report difficulties modifying a loan because of conflicting advice from front-line employees at the mortgage companies, processing delays and lost paperwork, among other things. Even worse, lenders may report the modifications to credit bureaus in ways that can hurt a good credit history—and make it more difficult to repair a damaged one. A damaged credit history can mar borrowers' ability to qualify for new credit or may prompt current lenders to cut existing credit lines.

Consumers looking to dig themselves out of a mortgage mess can take steps to minimize the potential fallout from loan modifications, and even from the more-serious consequences of so-called short sales.

Question: *How badly will a loan modification hurt my credit?*

Answer: That depends on what else is in your credit files, whether you were already delinquent on your payments and how the lender reports the modification to the credit bureaus.

Your score probably won't fall by much if your credit has already taken a beating. But if you're someone with pristine credit, getting a modification could cause your score to take a steep dive.

If you are opting for a modification under HAMP—in which mortgage payments are lowered to 31% of a homeowner's gross monthly income—you will likely have to go through a three-month trial period when you are paying a reduced amount before lenders approve the modification. If you were behind on your payments before

starting the trial period, lenders are supposed to continue reporting you as delinquent, which can hurt your score. (The loan modification could extend delinquency during the trial period. And once you're approved, the lender may continue to report the modification as "partial payment"—which generally hurts your score.)

If you're current, lenders are supposed to report you as current, but some lenders may also report the modifications as a "partial payment" of your mortgage, which is often considered a negative.

Q: Why would something endorsed by the government trash my credit score?

Many lenders and those in the credit-reporting industry have struggled to keep up with the dramatic housing remedies that Washington has devised.

Shortly after the government rolled out its modification program earlier this year, the Consumer Data Industry Association, which represents credit bureaus, advised lenders to classify such modifications as a "partial payment," a preexisting code that generally hurts your score. Under the widely used FICO model, for example, "partial payment plans" are considered comparable to a missed payment or some other type of derogatory or collection item on their file, says Tom Quinn, vice president of global scoring solutions at FICO.

But there's a temporary fix on the horizon. Starting in November, lenders will be able to use a new code that specifies whether a mortgage was modified under the government's plan. That code will reduce the hit to the credit files of people who work with the government to modify their loan; those who work directly with their own lender for more lenient terms could still see a significant hit if the lender reports their own modifications as a partial payment to the credit bureaus.

But while the new November status codes will have no impact on your score for now, that could change once the industry has had a chance to determine whether someone who modifies a loan is an elevated credit risk, says John Ulzheimer of Credit.com.

Q: Are loan modifications only for people who are seriously behind on their payments?

Not necessarily. Joanne Gregory of Fresno, Calif., for example, had never missed a payment but turned to the Making Home Affordable program to modify her two mortgages with Citigroup Inc.'s CitiMortgage because she was feeling the financial pinch of the recession. But because of delays in processing her applications, missing paperwork and conflicting information from representatives on when she needed to make payments, CitiMortgage began reporting her as delinquent to the credit bureaus earlier this year.

The 62-year-old retired teacher says she only became aware that something was wrong when her credit-card issuers began closing her accounts and slashing her credit lines this summer. "I thought I was getting involved in something that would be of temporary assistance until the economy turned around," says Ms. Gregory, who runs a small consulting practice and gets income from rental properties. "If they would have told me this would be a negative, I would not have done it."

A Citigroup spokesman declined to comment on Ms. Gregory's account, citing privacy restrictions, but noted in an e-mailed statement that the bank regrets any "misunderstanding."

Q: Am I better off avoiding a loan modification and simply going through a foreclosure?

No. Foreclosures are generally more damaging to your credit, and stay in your record for up to seven years. Many lenders, for example, will automatically deny credit applications if they see a foreclosure in your credit files, said Evan Hendricks author of "Credit Scores and Credit Reports."

The answer is less clear-cut for short sales. In a short sale, a bank agrees to accept less than the full balance of a mortgage as a settlement on the loan. Much depends on how that sale is reported to the credit bureaus by the lender, and whether the lender enters a so-called deficiency judgment for the sale—a court judgment ordering the borrower to pay the remaining balance, which would be especially damaging to one's credit score. (However, some states don't allow deficiency judgments.)

Q: What can I do to save my credit?

Consumers can negotiate with their lenders to report loan modifications and short sales in ways that are less damaging to their credit histories, says Sylvia Alayon, vice president of operations for the Consumer Mortgage Audit Center, which audits mortgages for attorneys and consumer groups.

Randy Wilburn, a real-estate broker and mortgage counselor in Boston who has helped negotiate loan modifications and short sales, says he has had some success in getting lenders to report a short sale to the credit bureaus as "paid as agreed"—which is less damaging to a person's score. "It is all in the language as to how it is reported to the credit bureau," he says.

Q: How quickly will my credit recover?

A bankruptcy can hurt your credit for up to 10 years, a foreclosure and other serious delinquencies for up to seven years. FICO, for example, classifies bankruptcies and foreclosures as negative items and treats them in a similar manner. Loan modifications and short sales can also be negatively classified, although that ultimately depends on how those items are reported on a credit profile, says FICO's Mr. Quinn. Under the VantageScore—an emerging competitor to FICO developed by the three major credit bureaus—scores can fall by as much as 140 points in a short sale or foreclosure and can plummet by as much as 350 in a bankruptcy, says Sarah Davies, head of analytics and product development at VantageScore Solutions LLC.

Borrowers with short sales and loan modifications should see their credit recover more rapidly if they keep making their payments on time, keep balances low and refrain from applying for new credit, said FICO's Mr. Quinn.

Write to Jane J. Kim at Jane.Kim@wsj.com and M.P. McQueen at Mari.McQueen@wsj.com

Copyright 2009 Dow Jones & Company, Inc. All Rights Reserved
This copy is for your personal, non-commercial use only. Distribution and use
of this material are governed by our [Subscriber Agreement](#) and by copyright
law. For non-personal use or to order multiple copies, please contact Dow
Jones Reprints at 1-800-843-0008 or visit
www.djreprints.com