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The Top Seven Myths About Loan Modifications

By Raffy M. Boulgourjian, Esq.

This reading is for you or anyone you may know who is looking for a way out of their loan nightmare. As a real estate attorney for more than 10 years, the recent economic downturn has brought dozens fearful and distressed homeowners to my office. In all my consultations, I have heard many beliefs about what can be accomplished in applying for a loan modification. The media, which buzzes daily with "promising" news, only aids in the confusion experienced by homeowners. It's no wonder then that the homeowners who sought my assistance came to me in complete bewilderment.

To help you navigate between truth and fiction, I have compiled the following – the seven most commonly seen misconceptions.

1. ***You must be behind on your payments to qualify for a loan modification***.

   This belief is patently false. However, the reason why this belief exists is because it was once true. Before the U.S. government got involved, most banks could not be convinced that you were suffering a financial hardship (and thus warranting their attention as a default risk) unless you were one, two or three payments behind. This is no longer true. On March 3, 2009, the U.S. government passed the *Making Home Affordable* plan to help fill some of the gaps in the process. One of those gaps was to assist homeowners who were experiencing financial hardship but were hanging onto their credit with everything they had, while keeping their payments current. In fact, under the government plan you *must* be current to qualify.

   I would never advise anyone with good credit to deliberately damage it by falling behind on their payments simply in the hope that it will increase their chances of obtaining a loan modification. Obviously, if you can't make the payment, then you don't have a choice; however, I don't recommend destroying your credit over it. Remember, your credit is the one thing that is going to help move you forward through your current financial squeeze. Maintaining your credit or minimizing the damage is paramount. There is no guarantee that your lender is going to offer you a loan modification.

2. ***If you qualify under the government criteria, then your lender must modify your loan.***

   The U.S. Making Home Affordable plan is just that -- a plan. The plan is not a law that obliges lenders to modify all qualifying persons' loans. The government plan provides the lender with a financial incentive to offer loan modifications to persons who qualify under the plan's criteria. If you are current on your payments, occupy the property as your primary residence, obtained your loan before January 1, 2009 and meet some other basic criteria, then you are a candidate for the program. If the lender approves your loan modification, then the lender receives a cash-back of close to $2,250 (depending on circumstances) for having approved your loan. It is neither obligated to do so, nor is it obligated to take the government assistance money.

3. ***My loan must be a FannieMae or Freddiemac loan to qualify for a loan modification.***

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In the early days of the government plan, both lenders and homeowners alike strove to digest its terms, causing much confusion. One of the most common misconceptions was that your loan must have originally been processed or backed by one of the above-mentioned loan giants in order to qualify under the loan modification plan. This is not true. The government's plan has two programs; one offering assistance with loan modifications, and the other with refinances. Your loan need not be a FannieMae- or FreddieMac-backed loan in order to qualify for a loan modification. However, if you plan to apply for a *refinance* under the government plan, then the above requirement applies.

The government plan for refinances was designed to assist those homeowners who were close to qualifying for a refinance but fell short by about 25 percent. If you owe more on your house than it is worth (i.e. the property is "upside down" or "underwater"), then no one will refinance your loan because your home does not offer sufficient collateral to cover the refinanced amount. However, in this case, you may qualify under the government's refinance plan. Its plan does require that the loan you are attempting to refinance have originally been a FannieMae- or Freddiemac-backed loan. How do you find out if your loan was a FannieMae or Freddiemac loan? For an immediate answer, visit their websites (*fanniemae.com* and *freddiemac.com*), and simply enter your street address.

4. ***A loan modification will reduce the principal owed on the loan.***

In a loan modification situation, this scenario is so rare that expecting it would simply be foolish. Please do not expect the first mortgage holder on your home to forgive the principal on your loan. If someone is promising you that it can be done, be careful. Is it unheard of? No. Is it extremely unlikely? YES.

Of the dozens of first mortgage loans that we have successfully modified, none have forgiven any portion of the principal. Again, it's not impossible. Lenders are far more inclined to forgive principal on your second mortgage, and then only in a short sale situation (where you are selling your home, not simply attempting to modify your loan).

Lenders can and will do many adjustments to the principal to reduce your monthly payment. One of the most common things that lenders do to the principal in a loan modification is to *defer* payment of a large portion of the principal to the maturity date of the loan (i.e a balloon payment) with no interest accruing on that principal (you could call this free money). Another principal modification that many lenders offer is to *extend the term of the loan (e.g. convert a 30-year loan into a 40-year loan starting today*) to keep the monthly payment amount within a tolerable range.

5. ***Under a loan modification, the lender will only consider the income of the debtor.***

I have had countless numbers of people ask if the bank would only consider the income of the individual named on the loan. The straight answer is "No." In reviewing your application for a loan modification, the bank will consider the *total income* of the household. If your spouse

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works, then their income is considered. It doesn't matter if you are the only one on the loan and the only one on title to the property. The bank will ask for the total income of all adults contributing to the household's income. If there are adult children who work and contribute, their income will be considered too. Understand that your lender will review your tax returns and determine the total income of the household by your (most likely) jointly filed tax return.

6. ***Foreclosure can be averted at the last minute by applying for a loan modification or a bankruptcy.***

The common advice of "Never leave anything to the last minute" could not be truer than in a foreclosure situation. Many states' laws require that a lender give you several months' notice before a foreclosure goes forward. Use this time wisely. Consult with an attorney. Find out what your options are. A lender will typically cancel, pause or postpone an upcoming foreclosure sale if you have applied for some form of assistance (loan modification, short sale, deed in lieu of foreclosure, forbearance agreement). However, your application will take several days to be inputted into the system and assigned to a negotiator. Most banks will not promise to stall a sale until your file is assigned to a negotiator. Don't put yourself in the uncomfortable situation of waiting for good or bad news on the foreclosure sale. Send in your paperwork at least two weeks (if not more) before a scheduled foreclosure date.

7. ***The banks are obligated to help you.***

No lender is obligated to modify your loan. No lender is going to cut you slack simply because you asked for it. Did the U.S. taxpayer just foot the bill to save our banking system from collapse? Yes. Was this collapse caused primarily by banks offering bad home loans? Yes. Does the plan obligate the banks to cut homeowners some slack? No.

When a lender decides to modify your loan, they do so because they feel it is in *their* best interest to do so. Keeping this truth in mind is key when preparing an application for a loan modification. The bank does not want to go through the expense of foreclosing (a typical foreclosure may cost your bank six months of time and over $10,000 in hard expenses). The bank does not want to become the new owner of yet one more foreclosed property. Having said that, the bank cannot stand aside and watch a bad loan get worse if there is any chance of saving it. If a borrower has *some income*, at least enough to keep the bank from losing money, then it will be interested in negotiation. By the same vein, banks want assurance that the new monthly payment is an amount that is not going to overburden the borrower (and hence cause them to be back at "square one" with a delinquent borrower in a few months' time). This delicate balance is what will make the difference between your loan modification being approved or denied. Keep in mind that for all of the above reasons, you simply will not qualify if you have *no* income. But if you can show that you can afford some amount, then you should at least try to apply.

Put your best foot forward financially. This is not the time to exaggerate your financial hardship. Be honest and offer what you can. If you simply have nothing to offer, then your next best

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option is to sell the property short or simply give it back to the bank. Both options have advantages that a loan modification cannot offer (such as forgiveness of principal).

Be vigilant, seek assistance from reputable professionals and explain your financial situation sincerely and frankly.

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