

Origination News

JULY 2010 • Volume 19, No. 10

For Mortgage Lenders, Brokers, Correspondents and Wholesalers

Special Report: **Loan Modification**

Study: Mod Effect On Credit Scores Not That Large

By Brad Finkelstein

RESEARCH CONDUCTED BY VantageScore Solutions counters the popular notion that a consumer's credit score would take a big hit if his or her mortgage were to be modified.

The company's president and chief executive Barrett Burns continued that entering a trial modification program would have no impact on the credit score in most circumstances.

Even if the modification would become permanent, there is no material impact of any significance, he said.

It is the levels of the delinquency that have the most impact on a score, so by the time the consumer gets to the modification stage, the damage already has been done, Burns explained. "Mortgage restructuring has a substantially lower impact as the level of delinquency increases," to the point where the borrower is significantly delinquent, there is no impact on the credit score.

VantageScore found that a forbearance or a modification had the least severe impact on the consumer's credit score. On the other hand, the items where mortgage payments are eliminated through "derogatory events" such as a short sale, a foreclosure or the borrower going into bankruptcy have a more severe impact on the credit score.

In a situation where the borrower is relatively clean on the first mortgage but delinquent on other trade lines in their

credit file, the borrower's starting score is 830. The impact to the credit score for a forbearance ranges from 0 points to a decline of 35 points and for a loan modification there could be a loss of 15 points up to an increase of 30 points to the score.

For the more severe outcomes, the credit score drop range is between 100 points (for a short sale) to 330 points (for a bankruptcy involving all trade lines).

In a scenario where the borrower is delinquent on all trade lines, the starting score is 625. Since it already has been hit, Burns pointed out, the impact is less in each scenario. If the borrower can get a forbearance the score could increase by 10 points. For a modification, the score might decrease by 5 points or increase by 18 depending on the situation.

If there is a short sale for a borrower in this circumstance, the hit to the score could be 25 points; a foreclosure fares slightly better at a 20-point hit.

For a bankruptcy, the score could go down 120 points.

Burns has a message for consumers—don't wait and become severely delinquent on your loan. He said he has seen items in the media which note consumers can only qualify for a modification if they become delinquent.

So contact the servicer early, before

the damage is done to the credit score. "However, once the damage is done, then they should try and get a forbearance or loan modification because they are not going to get hurt any more," he continued. "They need to take action if they want to get back on their feet."

So consumers should think proactively, so if they do need for some reason to apply for a new mortgage, to seek the less severe options so the damage is not worse.

Another issue is how the lender/servicer reports the loan modification to the bureaus. If it is done as a new credit, rather than an overwrite to the existing loan, there is a bigger hit to the score because it is a newer trade line.

VantageScore then looked at how fast the consumer could rehabilitate their score once they got back on their feet.

In a situation where the borrower's score has fallen to 625, if they are able to recast all of their debt, it only takes nine months to get back to being a prime credit (that is having a score of 700). If only the mortgage becomes current, after 24 months, they are still not back to 700. If there is a bankruptcy filing, the consumer is still well under 600 after 24 months.

So it is not hopeless to have good credit again, Burns said, if the borrower can get back on their feet. ♦