# *Before entering mortgage forbearance, read this*

## Forbearance should only be a last resort

Mortgage **forbearance** sounds like a great deal, especially if you've lost a job due to the coronavirus crisis.

Forbearance lets you skip some or all your monthly mortgage payments for as much as a year.

But forbearance should be a last resort, something to avoid if possible.

While it can be a lifeline in the short-term, forbearance will undoubtedly lead to credit issues for many down the road.

That's why it's so important to keep paying your mortgage if you're able, and only consider forbearance if it's necessary.

## Why borrowers and lenders want mortgage forbearance

Borrowers who cannot pay their mortgages — in most cases today, individuals with solid credit who have been blindsided by the COVID-19 virus — have little choice but to consider forbearance.

The lender and borrower with a forbearance plan agree to new mortgage terms for a short period.

A borrower might be able to make interest-only payments for a few months, or maybe just a smaller payment. Or, in some cases, the borrower might be allowed to skip up to a year's worth of payments altogether.

For borrowers, the harsh alternative to mortgage nonpayment is foreclosure.

Worse, foreclosure and bankruptcy often go together. They're a combination that can sink personal finances and credit scores for years.

Forbearance can also benefit lenders.

At first, this may seem unlikely. Why would a lender accept smaller monthly payments or maybe even no monthly payment?

Because foreclosures are hugely expensive, and in some states can be dragged out for months if not years.

If a borrower can get back on track with forbearance, that's best for them and the lender. And though it's not great, forbearance is at least better than a foreclosure.

## Issues with mortgage forbearance repayment

A mortgage forbearance plan is not a gift. It's certainly not free money. Money not paid during the forbearance period remains owed to the lender and must be repaid.

There are several ways missed payments during forbearance can be repaid:

- **Lump-sum repayments.** Lenders covered by federal forbearance rules cannot require a lump-sum repayment. However, you can – if you elect – repay the entire missed amount as a lump sum
- **Payment Plans.** You repay the lender by making larger monthly payments once the forbearance period ends
- **Loan modifications.** The lender changes the loan terms. Maybe the interest rate can be reduced, the loan term extended, or both

But each of the usual repayment options has practical problems.

**Lump-sum repayment issues**

If a borrower has a $1,200 monthly payment for principal and interest, and does not make payments for 12 months, the lender is owed $14,400.

A lump-sum payment of more than $14,000 would be difficult for obvious reasons. That's why the federal government has **banned lenders from requiring lump-sum repayments** on many COVID-19 forbearance plans.

**Payment plan issues**

The borrower might repay $200 a month for 72 months with a payment plan. The $200 extra payment is added to the $1,200 regular payment for a total of $1,400 monthly for six years.

This may sound acceptable in the short run, but once the forbearance period ends, will a larger monthly payment be affordable?

That will depend on how quickly each borrower is able to resume their usual hours and employment after the crisis is over.

*Consider: Once the forbearance period ends, will a larger monthly payment be affordable?*

More than **36 million** people became officially "unemployed" during the past two months. But the real job losses are even larger. And an additional **8.1 million** people were out of work as of April for what the government classifies as "other reasons."

Given such huge numbers, will forbearance plans that help today be replaced by foreclosure auctions and bankruptcies tomorrow?

Simply put, a lot of people will not be able to make the pre-COVID-19 payments that were once normal and routine.

**Loan modification issues**

Many borrowers can be helped by refinancing if rates turn lower. For those affected by COVID-19, a refinance could help by lowering your interest rate and monthly payment significantly.

However, homeowners who use forbearance may not be able to refinance for up to a year after their forbearance period ends.

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Why? Because many lenders will not consider a refinance application after forbearance **for at least 12 months**. They want to assure the borrower's income and credit are restored.

There's one big exception here: **FHFA recently announced** that loans backed by Fannie Mae and Freddie Mac may be able to refinance as early as three months after forbearance, provided they make three consecutive on-time payments after ending forbearance.

For other loan types — FHA, VA, USDA, and others — no similar policies have been stated yet.

So, while loan modification may be a better option than those listed above, it could still prevent you from taking advantage of rates falling into the low 3s and **even mid-2s** later on.

**The new payment deferral option**

The government has recognized the affordability problem that comes with forbearance and moved to do something about it.

As of May 13th, Fannie Mae and Freddie Mac will offer a “**payment deferral option**.”

Instead of charging higher monthly payments after a forbearance period ends, the payment deferral option allows borrowers, who are able to return to making their normal monthly mortgage payment, the ability to repay their missed payments at the time the home is sold, refinanced, or at maturity.

The missed payments during forbearance will be repaid when the home is sold, the loan is refinanced, or the loan reaches maturity.

A primary benefit of this option is that a homeowner’s mortgage payment will not change once the forbearance period ends.

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**Payment deferral pros and cons**

The new payment deferral option policy is an important — and positive — change. However, it is not an absolute safe haven for borrowers with forbearance plans.

The payment deferral option helps borrowers who face suddenly higher monthly payments. However, there’s still the problem of meeting bills established before forbearance.

Go back to the borrower with a $1,200 mortgage. Even without a requirement to pay an additional monthly amount, there’s still an obligation to pay the basic mortgage bill, that $1,200 a month.

Making those regular payments may not be possible for borrowers who lost their jobs or face sharply reduced incomes.

The payment deferral option applies to loans that involve government programs. There are millions of mortgages not covered by the plan. Will they get similar relief? We don’t know yet.

Lastly, what if the borrower must sell — perhaps to move for a job opportunity — but the property’s value is less than the loan balance?

Must the borrower bring cash to closing? Will the bank agree to a "short sale" where it accepts less than the full amount of the debt?

While payment deferral is an improvement over traditional forbearance plans for many, it's still not a free card and needs to be considered carefully.

**Credit penalties could still happen**

COVID-19 mortgage forbearance should not count against your credit. That's the theory, at least. The rules state that skipped payments during forbearance can't be reported as "late" or "missed" to count against your credit score.

However, it is possible that forbearance will lead to a negative credit ding.

The lender is responsible for reporting the account information to the credit bureaus.

The lender would likely stop reporting the forbearance comment once that temporary program has ended on the account. In other words, ideally, the forbearance should be wiped from your credit record once you're back on a regular payment schedule.

However, mistakes can creep into the credit reporting system.

Every lender will have its own system for reporting (or not reporting) forbearance. And with such an unprecedented volume of loans going into forbearance programs, it seems inevitable that some of the proper labeling could slip through the cracks.

Thus, borrowers could be said to have late or missing payments when they were really in forbearance. Or the forbearance mark could linger on a report longer than it's meant to.

The good news is that the nation's three largest credit reporting agencies — Equifax, Experian, and TransUnion — announced in April that they will provide **free weekly credit reports** for a one-year period.

Borrowers can check their reports at **AnnualCreditReport.com**. Given so many changes to the financial system, it's important for borrowers to check regularly their credit reports for factual errors and items that are out-of-date.

**Strategies to avoid forbearance**

Forbearance is better than foreclosure and that makes it valuable, especially with tens of millions of workers suddenly out of a job.

However, if it is possible borrowers should consider avoiding forbearance.

How can the unemployed avoid forbearance? There are no easy answers, but there are several alternatives to consider.

- **Use that $1,200 government check** toward the mortgage. It likely won't cover multiple payments, but it's a start
- **Pull money from retirement accounts.** The CARES Act allows hardship withdrawals from retirement, as much as $100,000 without penalty. Borrowers have three years to pay the taxes. Speak with a tax professional or retirement account executive for details
- **Borrow from a credit card.** Not a cheap solution, but if you expect to quickly recover, credit cards can be a ready and manageable cash source
- **Make use of overdraft credit lines.** You may have to operate at a loss for several months, but overdraft credit lines can give you the flexibility to pay mortgage bills when due. However, lenders have already begun to reduce credit card limits and — as they did during the mortgage meltdown — banks can stop additional withdrawals from home equity lines-of-credit (HELOCs). So, your options may be more limited than before
- **Ask for help from friends and relatives.** Maybe someone has a few dollars that can become a gift or friendly loan. Not easy to do in normal times — and not easy to do in many cases because of

non-financial issues such as status and ego — but a potential option.

Hard times may offer some leniency, at least in the short run, but ultimately lenders want their money back.

For many borrowers the big question is not whether to borrow, but how to borrow today and avoid bigger financial problems tomorrow.

**Background on CARES Act mortgage forbearance**

The old forbearance standards are gone for millions of loans. The government passed the Coronavirus Aid, Relief, and Economic Security Act (CARES) in mid-March.

CARES is a $2 trillion bailout that includes borrower protections for mortgages backed or funded by the FHA, VA, USDA, Fannie Mae, or Freddie Mac.

This legislation radically changed the mortgage marketplace. Data provided by mortgage data firm Black Knight shows what happened.

- In February there were fewer than 150,000 forbearance plans nationwide
- By May 12th, there were nearly 4.7 million forbearance plans in place, a 31-fold increase

The CARES act offers several important protections for mortgage borrowers.

1. **First, foreclosures are banned for the time being.** Foreclosures were initially banned for 60 days, starting on March 18th. However, instead of ending May 17th, the moratorium has now been extended until June 30th. Will the foreclosure moratorium be extended again? We don't know for sure, but extensions seem likely. Speak with lenders for details.
2. **Second, most homeowners have a legal right to forbearance.** According to the Consumer Financial Protection Bureau (CFPB), "if you experience financial hardship due to the

coronavirus pandemic, you have a right to request a forbearance for up to 180 days. You also have the right to request an extension for up to another 180 days."

3. **Third, there can be no late fees or penalties during forbearance.** "There will be no additional fees, penalties or additional interest (beyond scheduled amounts) added to your account," according to the CFPB. "You do not need to submit additional documentation to qualify other than your claim to have a pandemic-related financial hardship."

But there are a couple of important caveats to these protections.

For one, the CARES Act covers millions of loans, but it does not cover all mortgages. If your mortgage is not backed by Fannie Mae, Freddie Mac, or one of the government agencies, it is possible that your loan is not protected under the CARES Act.

Speak with your lender or loan servicer for more information.

**Most importantly:** In every case it is up to you, the borrower, to initiate contact with your loan servicer. Forbearance will NOT be applied automatically. Your servicer's contact information is on your monthly statement or online.