# *What is mortgage loan modification, and is it a good idea?*

**Trouble paying your mortgage? You have options.**

You might be wondering about mortgage loan modification if you're:

- Experiencing financial hardship
- Having trouble making your monthly mortgage payments
- Currently in forbearance but worried about what will happen when it ends

The good news is help is available. But mortgage relief options are not one-size-fits-all. Depending on your circumstances, you may be eligible for a loan modification or a refinance. Here's what you should know.

**What is loan modification?**

Loan modification is when a lender agrees to alter the terms of a homeowner's existing loan to help them avoid default and keep their house during times of financial hardship.

The goal of a mortgage loan modification is to reduce the borrower's payments so they can afford their loan month-to-month. This is typically done by lowering the mortgage rate or extending the loan's repayment term.

A mortgage loan modification does not replace your existing home loan or your lender. However, it restructures your loan in the interest of making it more manageable when you experience difficulties in making your mortgage payments.

**How mortgage loan modification works**

With a loan modification, the total principal of your existing loan amount won't change.

Rather, your lender may agree to a lower interest rate or to lengthen the payoff terms of your home loan.

Any of these strategies could help reduce your monthly mortgage payments and the total amount of interest you pay in the long run.

Modification can also include switching from an adjustable-rate mortgage to a fixed-rate loan and rolling late fees into your principal, adds Condor.

Keep in mind, loan modification is intended to make a mortgage more affordable month-to-month. But it often involves extending the loan term or adding missed payments back into the loan — which may increase the total amount of interest paid.

Refinancing into a new loan, on the other hand, often reduces the monthly payment and the total interest cost.

**Loan modification vs refinance**

A refinance is typically the first plan of action for homeowners who need a lower mortgage payment.

Mortgage refinancing can replace your original loan with one that has a lower interest rate and/or a longer term. This may offer a permanent reduction in mortgage loan payments without negatively affecting your credit score.

However, borrowers going through financial hardship might not be able to use a refinance program.

They may have trouble qualifying for the new loan due to a reduced income, lower credit score, high-interest credit card debt, or other unexpected debt obligations (such as medical expenses).

In these cases, the homeowner might be eligible for a mortgage loan modification.

Loan modification is usually reserved for homeowners who are not eligible to refinance due to financial hardship.

## When to pursue mortgage loan modification

Mortgage modification is usually reserved for borrowers who do not qualify for a refinance and have exhausted other possible mortgage relief options.

With a loan modification, you work with your existing bank or lender on modifying the terms of your existing mortgage.

If you've defaulted on your existing mortgage, chances are your credit has been negatively impacted to the point where a new lender would be wary to give you a new loan.

Typically, a refinance is not possible in this situation.

That means there's no real contest between loan modification versus mortgage refinancing. The right loan option for you will depend on the status of your existing loan, your personal finances, and what your current lender agrees to.

## Loan modification vs forbearance

Forbearance is another way servicers can help borrowers during times of financial stress.

**Loan forbearance** is a temporary plan that pauses mortgage payments while a homeowner gets back on their feet.

For example, many homeowners who lost their jobs or had reduced income were able to request forbearance for up to a year or more during the COVID pandemic.

At this time, it may be much less of an option due to the amount of forbearance provided early on, during COVID, and many are now becoming due.

Unlike forbearance, mortgage loan modification is a permanent plan that changes the rate or terms of your loan.

Forbearance and loan modification can sometimes be combined to make a more effective mortgage relief plan.

For instance, a homeowner whose income is still reduced at the end of their forbearance period may be approved for a permanent loan modification.

Or a homeowner approved for mortgage modification may also have part of their unpaid principal forborne (put off) until the end of the repayment period.

**Who is eligible for a loan modification?**

To qualify for a loan modification, a borrower usually must have missed at least three mortgage payments and be in default.

Sometimes, a borrower who has experienced financial setbacks, which makes a default imminent, can qualify for a loan modification. But not everyone in default under their mortgage is eligible for a loan modification.

Borrowers whose financial setback is so severe that they will never be able to repay their mortgage won’t receive a modification, nor will borrowers who can make mortgage payments either from their income or savings. Borrowers whose financial setback is so severe that they will never be able to repay their mortgage won’t receive a modification

In addition to providing a hardship letter or statement to your current lender, prepare to provide proof of income, two years’ worth of tax returns, bank statements, and other financial statements.

Be aware, however, that your mortgage lender is not obligated to provide a loan modification.

Once a lender has an executed contract — meaning the home loan — they don’t have to change it. Many [homeowners] are denied a mortgage loan modification.

If the lender desires to modify the terms, per your request, then you have a starting point.

## How to request a loan modification

The process for requesting a loan modification will vary depending on who manages your loan.

The first thing you need to do is contact your loan servicer. This is the company to which you send payments, and the one you need to work with to determine your options for loan modification.

Some mortgages are managed, or "serviced" by the original lender. But most home loans are serviced by a separate company.

For instance, you may have received the loan from Wells Fargo, but now make payments to U.S. Bank.

The loan servicer is the company that takes your monthly mortgage payments; you can find yours by checking the name and contact information on your latest mortgage statement.

Many borrowers begin the process by sending a hardship letter to their servicer or lender. A hardship letter is simply a note that describes the borrower's financial difficulties and explains why they can't make loan payments.

The mortgage lender will likely request financial information and documentation, including bank statements, pay stubs, and proof of your assets.

These documents will help your current lender understand the full scope of your personal finances and determine the correct path for mortgage relief.

## Mortgage loan modification programs

Your loan modification options will depend on the type of loan you have and what your lender or loan servicer agrees to.

## Conventional loan modification

Fannie Mae, Freddie Mac, and private lenders of conventional loans have their own modification programs and guidelines.

Freddie Mac and Fannie Mae offer Flex Modification programs designed to decrease a qualified borrower's mortgage payment by about 20%.

Flex Modification typically involves adjusting the interest rate, forbearing a portion of the principal balance, or extending the loan's term to make monthly payments more affordable for the homeowner.

To be eligible for a Flex Modification program, the homeowner must have:

At least three-monthly payments past due on a primary residence, second home, or investment property

Or less than three monthly payments past due but the loan is in "imminent default," meaning the lender has determined the home loan will certainly default without modification. This is only an option for primary residences

Certain hardships can trigger imminent default status, for instance, the death of a primary wage earner in the household, or serious illness or disability of the borrower.

Unemployment is typically not an eligible reason for Flex Modification.

Borrowers who are unemployed are more likely to be placed in a **temporary forbearance plan** — which pauses payments for a set period of time but does not permanently change the loan's term or interest rate.

In addition, government-backed FHA loans, VA loans, and USDA loans are not eligible for Flex Modification programs.

**FHA loan modification**

The Federal Housing Administration offers its own loan modification options to make payments more manageable for delinquent borrowers.

Depending on your situation, FHA mortgage modification options may include:

- Lowering the interest rate
- Extending the loan term
- Rolling unpaid principal, interest, or loan costs back into the existing loan's balance
- Re-amortizing the mortgage to help the borrower make up missed payments

In some cases where extra assistance is needed, FHA borrowers may be eligible for the FHA-Home Affordable Modification Program (FHA-HAMP).

FHA-HAMP allows the lender to defer missed mortgage payments to bring the homeowner's loan current. It can then request that HUD (FHA's overseer) further reduce the monthly payment by opening an interest-free subordinate loan of up to 30% of the remaining loan balance. The borrower only pays principal and interest based on 70% of the balance and can pay back the remainder upon a sale or refinance of the home.

Deferring this extra principal amount can help make it easier for FHA borrowers to get back on track with their loans.

FHA-HAMP is typically combined with one of the loan modification options above to lower the borrower's monthly payment.

Eligible FHA borrowers must complete a trial repayment plan to qualify for either loan modification or the FHA-HAMP program. This involves making on-time payments in the modified amount for three months straight.

### VA loan modification

Veterans and service members with loans backed by the Department of Veterans Affairs can ask their servicer about VA loan modification.

VA loan modification can roll missed payments back into the loan balance, as well as other delinquent homeownership costs like unpaid property taxes and homeowners insurance.

After these costs are added to the loan, the borrower and servicer work together to establish a new repayment schedule that will be manageable for the veteran.

Note, VA modification is unique in that the interest rate might increase. So, while this plan can help veterans bring their loans current, it won't always reduce the homeowner's monthly payments.

For VA loan modification, several requirements apply:

- Your VA loan must in default
- You must have since recovered from the temporary hardship that caused the default
- You must be able to support the financial obligations of the modified VA loan
- You must not have modified your VA loan in the past three years"

Some homeowners with VA loans may qualify for a Streamline Modification.

Streamline Modification does not require as much documentation as the traditional VA modification plan, but includes two extra requirements:

The combined principal and interest payment must drop by at least 10%

The borrower must complete a 3-month trial repayment plan to prove they can make the modified payments

Talk to your loan servicer about options for your VA loan.

**USDA loan modification**

**USDA loan modification** is for homeowners whose current loans are backed by the U.S. Department of Agriculture.

A USDA loan modification allows missing mortgage payments (including principal, interest, taxes, and insurance) to be rolled back into the current loan balance.

USDA modification plans also allow a loan term extension up to 480 months, or 40 years total, to help reduce the borrower's payments. And the loan servicer can lower the borrower's interest rate, "even below the market rate if necessary," according to **USDA**.

Servicers may cover up to 30% of the homeowner's unpaid principal balance using a mortgage recovery advance.

Contact your loan servicer to find out whether you're eligible for a USDA loan modification.

**Is mortgage loan modification a good idea?**

A mortgage loan modification is worth pursuing for the right candidates.

A modification can give you a second bite at the apple and get you out of the default or foreclosure process, allowing you a chance to remain in your home.

But caveats apply.

Typically, a modification will take all your missed payments and add those to the outstanding principal balance.

For instance, say your current mortgage has an outstanding balance of $300,000. Assume you missed $50,000 in payments. In this example, your modified balance would be $350,000, which is called "capitalization."

But imagine your home's value is only $310,000. Here, a modification would allow you to stay in your home and avoid foreclosure, but you would owe more than your house is worth. That would be a problem if, say, two years after modification you wanted to sell your home.

**Mortgage refinancing and other alternatives to modification**

Loan modification isn't your only option, thankfully. Possible alternatives include refinancing, forbearance, a deed-in-lieu of foreclosure, or Chapter 13 bankruptcy.

Keep in mind [bankruptcy] will severely affect your prospects of obtaining a mortgage in the following year.

**Mortgage refinancing**

As mentioned above, you should first check if you're eligible to lower your interest rate and payment with a mortgage refinance.

You'll have to qualify for the new mortgage based on your:

- Credit score and credit report
- Debt-to-income ratio (DTI)
- Loan-to-value ratio (your loan balance versus the home's value)
- Income and employment

It may be difficult to qualify for a refinance program during times of financial hardship. But before writing this strategy off, check all the loan options available.

For instance, FHA loans have lower credit score requirements and allow higher DTI ratios than conventional loans. So, it may be easier to refinance into an FHA loan than a conventional loan.

**Refi Possible**

**Refi Possible** is a loan program offered through Freddie Mac that is designed to assist lower-income homeowners to pay less when refinancing their mortgages and to take advantage of lower interest rates.

With Refi Possible, you are guaranteed an interest rate reduction of at least 0.5% (50 basis points). This could equal big savings on your monthly mortgage payments.

As an example, if the rate on your current loan is 4.0%, the Refi Possible program drops the rate to 3.5% or lower.

The program also covers the cost of a new appraisal, if one is required by your lender.

Good candidates for Refi Possible are homeowners with:

- An existing loan balance at or below $600,000
- Credit score of 620 or higher
- A goal of creating more financial and savings opportunities

By reducing your monthly payments, this loan program can increase your household cash flow for debt repayment, investments, savings, and other personal finance needs.

**RefiNow**

Fannie Mae's **RefiNow** is another loan program intended to soften the cost of refinancing for lower-income households. It offers benefits such as reduced monthly payments, a lower interest rate, and a waiver for the cost of a home appraisal.

Like Refi Possible, RefiNow helps homeowners take advantage of today's low-rate environment, but without worrying about borrowing costs depleting their savings to the extent that a traditional refinance would.

There are requirements to qualify for RefiNow, including:

- Already have a Fannie Mae-owned mortgage*
- Earn an income below your area's median income*
- No missed mortgage payments over the past six months, and no more than one missed payment in the past 12 months
- Credit score of 620 or higher
- Loan-to-value ratio of 97% or less
- Debt-to-income ratio of 65% or less

*Use Fannie Mae's area median income lookup tool to determine your area's median income. Similarly, confirm your loan is owned by Fannie Mae using the mortgage loan lookup tool.

While this program does not allow cash-out refinancing, eligible homeowners can drop their interest rate and pay less over the life of their home loans.

### Streamline Refinancing

Homeowners with FHA loans, VA mortgages, and USDA loans have an additional option in the form of Streamline Refinancing.

A **Streamline Refinance** typically does not require income or employment verification, or a new home appraisal. Even the credit check might be waived (though the lender will always verify you have been making mortgage payments on time).

These loans are a lot more forgiving for homeowners whose finances have taken a downturn.

Note that Streamline Refinancing is only allowed within the same loan program: FHA-to-FHA, VA-to-VA, or USDA-to-USDA.

### What should you do?

Whitman continues, “Any borrower who will struggle to repay their mortgage and other debts after a loan modification should consider whether it is better to dispose of their home and find a more affordable housing option.”

To better determine if a refinance or mortgage loan modification is the right strategy for you, consult with your loan servicer, an attorney, or a housing counselor.

## Mortgage loan modification FAQ

### What happens when you get a loan modification?

The goal of a loan modification is to help a homeowner catch up on missed mortgage payments and avoid foreclosure. If your servicer or lender agrees to a mortgage loan modification, it may result in lowering your monthly payment, extending or shortening your loan’s term, or decreasing the interest rate you pay.

### How do I get a mortgage loan modification?

Contact your mortgage servicer or lender immediately to alert them of your financial hardship and ask about loan modification options available. Be ready to provide all documentation requested, which can include financial statements, pay stubs, tax returns, and more.

### How long does loan modification last?

Expect your loan modification process to take anywhere from one to three months, according to finance and insurance expert Karen Condor. Once your loan modification has been approved, the changes to your interest rate and loan terms are permanent.

### Does loan modification hurt your credit?

A mortgage loan modification under certain government programs will not affect your credit. "But other loan modifications may negatively impact your credit and show up on your credit report. However, since your mortgage usually must be in default to request a modification, your financial difficulties are probably already on your credit report," explains attorney Elizabeth Whitman.

### Can you be denied a loan modification?

Yes. A mortgage loan is a contract, and the mortgage lender isn't obligated to agree to a loan modification. "Borrowers whose financial situation is such that they will never be able to repay their mortgage loan, as well as borrowers who do not cooperate with lender requests, are likely to be denied a modification," says Whitman.

### How much does mortgage modification cost?

While there are no closing costs for a mortgage modification, your existing lender may charge a processing fee. "If your modification involves extending your loan's term, that means you'll pay more interest over the life of your loan," explains attorney Charles Gallagher.

## Do you have to pay back a loan modification?

Paying back a loan modification will depend on the type of modification you are given. “Your lender can apply a reduced interest amount to your loan’s principal on the backend that you must later pay back,” says Condor. “With a principal deferral loan modification, your lender reduces the amount of principal paid off with each payment. But the amount of principal your lender deferred will be due when your loan matures, or the home is sold.”

## Understand your mortgage options

Mortgage loan modification is typically reserved for homeowners who are already delinquent on their loans.

If you’re worried about mortgage payments, get ahead of the issue by checking your eligibility for a refinance or contacting your loan servicer about options before your loan becomes delinquent.

Many homeowners are facing financial hardship right now, and many lenders and mortgage loan servicers are willing to help. But help is only available to those who ask for it.