INSIDER

WHAT IT MEANS TO DEFAULT ON A LOAN AND HOW TO RECOVER IF IT HAPPENS

By: Sarah Sharkey - Jan. 5, 2023

You may have taken out a loan to finance a number of purchases — for instance, a house, a car, or your education. However, if you fall behind on your payments, your loan may go into default, which can come with some serious consequences.

No one wants to default on a loan. But, in case you do, it's helpful to understand the implications.

What does it mean to default on a loan?
Defaulting on a loan happens when you miss payments for a certain amount of time. In other words, failing to keep up your end of a loan agreement can eventually push your loan into default.

Before you officially default on the loan, there is often a grace period, called delinquency, between missing a payment and defaulting on the loan. The length of the delinquency period varies based on your loan, but it kicks off as soon as you miss a payment. Depending on your loan type, this grace period is often in the range of 30 to 90 days.

Defaulting on a loan can damage your credit score significantly, cost you thousands in accumulated interest, and prevent you from getting another loan in the future.

If you default on a secured loan, the lender may have the right to repossess your collateral. For example, if you default on your mortgage payments, the lender can foreclose on your home. If you default on unsecured debt, the lender cannot immediately claim your assets. However, the lender can pursue legal action to obtain payment.

How long do I have until I default on my loan?
While the exact number of days varies from lender to lender, you can expect your loan to fall into default after you've missed payments for a set period.

If you are falling behind on your payments or fear you might, reach out to your lender immediately. Ask about deferment options, which involve a temporary pause to your payment obligations for a set period. Even a short reprieve might give you enough time to get back on track with your loan payments.

If your lender will not grant a deferment, here's how much time you may have before you are in default. Of course, the numbers in the chart below are only estimates. If you need specifics, reach out to your lender to better understand their rules.

What are the consequences of defaulting on a loan?
The type of loan you default on comes with different consequences. Depending on the type of loan, you may have your wages garnished, collateral seized, or home foreclosed upon. As your default period stretches out, you may also rack up thousands of dollars in unpaid interest.

"Most loan agreements for homes and vehicles also allow for the physical repossession of the property if the debt is in default," says Todd Christensen, an AFCPE-Accredited Financial Counselor. "While the lenders don't typically want to repossess your vehicle or foreclose on your home, they will begin these proceedings if they feel it is their least worst option."

Additionally, defaulting on a loan can significantly damage your credit score. Payment history accounts for 35% of your FICO score. If you miss multiple payments, this can drag your credit score down.

Importantly, it is not a crime to default on a loan. No lender can have you arrested for failing to pay a loan. Defaulting on a loan may be a civil offense, and you might have to appear in court. But you won't serve jail time for defaulting on a loan.

How to get out of loan default
"Communication is the key component," says Ryan Cicchelli, founder of Generations Insurance & Financial Services. "As long as you stay in consistent contact with them and take advantage of any hardship assistance they may offer, the chances of defaulting on a loan diminish substantially."

If you are facing default on your loans, consider loan consolidation. When you consolidate your loans,you get a loan from one lender for the total amount of debt you'd like to combine. Then, you use those funds to pay off the individual, smaller debts. At the end, you have all of your debt rolled into one monthly payment, one deadline for debt repayment, and a smaller interest rate.

For federal student loan borrowers, loan rehabilitation is a possibility. When signing up for loan rehabilitation, you'll need to agree to make nine voluntary and affordable monthly payments within 20 days of the due date over a consecutive period of 10 months.

Other options include working with a credit counselor. Depending on the size of your defaulted loan, you may also consider bankruptcy as an option of last resort.

Ryan Cicchelli, founder of Generations Insurance & Financial Services, is committed to providing clients with financial security though a personalized, friendly approach. Ryan's top concern is helping clients make informed decisions about all things related to healthcare and retirement.

To contact Ryan, call 231-878-7074 or visit www.GenerationsIFS.com