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Hidden Medical Debt Trips Up Homeowners

By JESSICA SILVER-GREENBERG

Two erroneous $11 doctor bills stopped Jeanne White from refinancing her home.

The 49-year-old resident of Colleyville, Texas, pays 7% on the mortgage for her three-bedroom house. In October, she says, she was shocked to learn that the two medical bills, which had been turned over to a collection agency, had caused her credit score to fall to 680 from 757—making refinancing far too expensive.

"I was told I'd have to pay $14,000 in closing costs to get a 5.5% interest rate," Ms. White says, substantially more than she would have paid with a higher credit score. When Ms. White, a retired sales manager, contacted the doctor's office, she found out the bills had been issued in error.

Ms. White's case is hardly an isolated one. Otherwise well-qualified borrowers with good loan-to-value ratios and steady employment are increasingly finding it difficult to refinance because of medical billing mistakes marring their credit, say mortgage bankers and real-estate agents.

Matt Nager for The Wall Street Journal

Jeanne White of Colleyville, Texas, saw her refinancing costs skyrocket after her credit score was dinged by two disputed $11 doctor bills—and is now in limbo as interest rates rise.

Rodney Anderson, executive director of Supreme Lending, a mortgage bank in Plano, Texas, calls medical debt the single biggest roadblock for would-be refinacers. "People have no idea that they still owe small amounts which later end up on their credit report," he says.

'The Rates Are the Bait'

Despite record-low mortgage rates, refinancing activity has been lower this year than many in the industry would have expected. Last month, applications for refinancing fell 18% from their 2010 high in August, according to the Mortgage Bankers Association, even as rates for 30-year fixed-rate loans hit a record low of 4.17% in the second week of November. (They rose to an average 4.61% this week.)

"The rates are the bait," says Brian Wickert, president of Wisconsin-based lender Accunet Mortgage. "But when consumers begin to refinance, there are real impediments spoiling the refi party."

Earlier this month, Mr. Anderson says, he counseled a client whose $42 medical debt meant he would have to pay $4,200 in points to refinance his $300,000 mortgage.

Some 14 million Americans have errors on their credit report because of medical collections, according to the Commonwealth Fund, a Washington-based nonprofit focused on health-care research. These routinely small-balance blemishes, which can go unnoticed for years, can be a death knell for refinancing because they can cause outright refusals—or make closing costs so high that borrowers opt not to refinance at all.

Until she tried to refinance, Ms. White says, she had no idea about the overdue medical bills, which were from a visit earlier this year to an orthopedist. She has since disputed the charges, which will be removed from her credit reports within 30 days, but is worried about rising interest rates. "I'll have missed the window," she says.

Disputed Hospital Bills

For Debra Thomas, it was a disputed hospital bill that derailed her plans to refinance her Baltimore home. She wanted to use the savings from refinancing her $160,000 mortgage to renovate her kitchen, deck and patio. But when the 62-year-old approached several lenders in April, she says, the banks required more than $12,000 in closing costs to secure a lower rate because of her credit score.

It turns out that an unpaid $343 hospital bill incurred during a short stay in Maine was sent to a collection agency. Until she was contacted by the agency last year, Ms. Thomas says, she had no idea she owed any money. She is disputing the bill since she says she never received any notification of money owed.

"Other than this error, my credit is excellent, and I clearly would have paid the bill had I known about it," she says. "Now, this whole other part of my life is impacted."

Pricier "jumbo" loans—those of more than $729,750 not backed by government-sponsored agencies like Fannie Mae or Freddie Mac—can prove especially difficult to refinance. Investors' appetite for such loans has waned, which means that banks typically have to keep these loans on their books.

A bill wending its way through Congress could provide relief for homeowners with medical-debt troubles. The Medical Debt Relief Act, which passed the House this fall and is now in the Senate, would remove settled medical debt from credit reports after 45 days, instead of the customary seven years.

Yet borrowers shouldn't wait for relief from Washington, says Mark Rukavina, executive director of the Access Project, a Boston-based health-advocacy group, since the chances are slim that the bill will be signed into law anytime soon. Instead, they need to take action themselves.

"Don't assume that your credit score is pristine, and be vigilant about checking it for these medical bills," Mr. Rukavina says, adding that borrowers should also contact a medical provider's office immediately after a visit to ensure that all outstanding bills are covered.

If homeowners are thinking about refinancing, they should pay close attention to their so-called utilization rate. They need to pay down as much credit-card debt as they can, says Beverly Harzog of Cardratings.com, a consumer-education website. Also, they should beware of closing existing credit-card accounts because those factor into a credit score.

"In this environment," says Greg McBride, a senior financial analyst at Bankrate.com, "borrowers have to be more assertive about making the case to lenders that they are a good borrowing risk."