UNDERSTANDING YOUR OPTIONS: MORTGAGE REFINANCE AND HOME-EQUITY LOANS

First Edition

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NeighborWorks® America

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Important Note About *Understanding Your Options: Mortgage Refinance and Home-Equity Loans,* First Edition, 2006

This manual and training materials, which include a glossary, teaching tools, participatory activities and visual aids, are written for nonprofit homeownership trainers and counselors. This manual is not designed as stand-alone reading materials for consumers. If you have received this from a housing counselor, you should either be enrolled in or have completed an organized training course. These materials were specifically developed for use by NeighborWorks® organizations and other housing counseling agencies, such as those approved by the U.S. Department of Housing and Urban Development.

NeighborWorks® America designed this manual to help educate or counsel homeowners through an organized postpurchase homeownership education or counseling curriculum about their options for refinancing an existing mortgage loan or borrowing money from equity in their home. This module is designed to serve as a national curriculum and does not account for regional differences. In order to maximize the effectiveness of the curriculum, NeighborWorks® America recommends that each housing counselor use this module as a base from which to tailor the contents to fit local markets and conditions.

NeighborWorks® America, in partnership with leading experts, developed these materials to fill the void in existing nonprofit consumer education programs on mortgage refinance and home-equity loans. We recognize the important role refinance and equity loans can and do play for homeowners, and in response developed this — the first national curriculum on mortgage refinance and home-equity loans targeted to housing counselors. We recognize this is only a beginning, and look forward to improving this module over time. As you work with these materials and adapt them, please send us your ideas and feedback. With your help, we can make this even better. Check www.nw.org for future editions and revisions of this document, and e-mail comments to hbemanual@nw.org.

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FORWARD

January 2006

Dear Colleague:

NeighborWorks® America is pleased to offer this manual and accompanying training materials to homeownership trainers and counselors at nonprofit organizations that are interested in helping homeowners make wise decisions about mortgage refinance and home-equity loans.

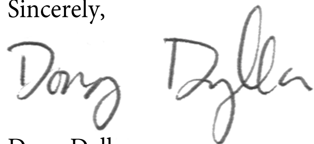
NeighborWorks® America is a national nonprofit organization created by Congress to provide financial support, technical assistance and training for community revitalization efforts. The NeighborWorks® Campaign for Home Ownership, an initiative of NeighborWorks® America, is the largest effort of its kind to bring families of modest means into the economic mainstream by helping them to achieve one of their primary goals in life: buying a home. This curriculum is part of an effort to work with leaders in the community development field on postpurchase homeownership issues.

Mortgage refinancings boomed in 2002 and 2003. During this period, however, lower-income homeowners were significantly less likely than higher-income homeowners to seek refinances of their mortgages, even though their mortgage rates were above current market levels — sometimes by several percentage points. Many of these homeowners lacked the knowledge of when and how to refinance, and also lacked the savings to pay for the related fees. As long as homeowners in underserved communities are locked into unnecessarily high-rate loans, they are losing wealth and assets relative to other populations and communities.

During and since the refinance boom, home-equity loans have also experienced explosive growth. With consumer spending outpacing income growth and property values rising in many markets in recent years, homeowners have turned increasingly to home-equity lending as a substitute for consumer credit to finance new consumption or reduce outstanding consumer debt.

We hope this manual will be a useful tool for trainers and counselors to help lower-income households manage their home equity effectively and maximize their potential for building personal wealth.

Sincerely,



Doug Dylla
Senior Manager
NeighborWorks® Campaign for Home Ownership

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OBJECTIVES

Welcome to *Understanding Your Options: Mortgage Refinance and Home-Equity Loans.* Buying a home probably took considerable time and effort, but now you are a proud homeowner!

Your hard work is not over. You earned the dream of homeownership — likely the largest investment you will ever make. Now you have to protect not only your shelter but also your home as a financial asset. Safeguarding your home involves many tasks, such as routine home maintenance and ongoing financial management.

Managing your personal finances wisely is a critical part of owning a home and achieving financial security. As you may already know, money management is about choices — choosing how to spend and save your money. As a homeowner, your options may include adjusting your mortgage payments or terms by refinancing, or borrowing against the equity in your home to get cash for remodeling. Whether or not to refinance your mortgage for better rates or different terms, or to tap into your home equity, can be difficult decisions to make, influenced by many factors.

This manual gives you information on how to manage your home as a financial asset. It will help you consider when it makes sense to refinance for different mortgage rates or terms. And it will help you determine when it is wise to obtain a loan against the equity in your home. It covers:

- Options and special considerations for refinancing for better rates or different terms;
- Options and special considerations for borrowing from home equity;
- How to shop for a refinance or equity loan;
- The terms and costs of refinance and equity loans; and
- How to avoid predatory lending.

This manual includes a glossary of terms beginning on page 52. Terms that are included in the glossary are noted in **bold** throughout the text.

SECTION 1: UNDERSTANDING YOUR FINANCIAL GOALS

In the process of buying your home, you learned the importance of money management to achieve your goal of homeownership. Financial management is just as important now to help you maintain homeownership over the long term. Managing your money wisely will help you make your mortgage payments on time, protect your credit rating and continue the habit of saving for emergencies, home maintenance and other financial goals.

While your **mortgage** is a long-term debt that could last for decades, homeownership comes with benefits. Your home is a financial **asset** that can serve as a foundation for your economic security. With careful financial planning, your home can help you build wealth through home **equity.** The difference between what your house is worth and the amount you owe is your home equity. In other words, equity is your ownership interest in the property, which you may be able to borrow against or convert into cash by selling your home. There are two main ways to build equity. First, as you continue to live in your home and make mortgage payments, your loan balance decreases and you build equity. Second, if the value of your home increases either because of home prices rising in your area or improvements you make to it, you may build equity.

In order to enjoy the benefits of your home as a financial asset, you must preserve and protect your investment by performing routine home maintenance and ongoing financial management. Financial management involves planning how to spend and save your money. As an owner, your home represents a significant obligation as well as an opportunity for managing your money. Luckily, you have options for how you handle the obligation of making your mortgage payments through refinancing your loan for a better rate or different terms. In addition, you may have opportunities to convert some of your home equity into cash you need for other purposes.

Over time, your financial needs may change and you may need to make adjustments to your spending plan. Because mortgage rates and household finances change, you may find that your mortgage financing no longer matches your current needs. One option for you might be to modify your mortgage payments by **refinancing** for different loan terms. Even if your financial needs have not changed, you may want to consider refinancing to take advantage of lower **interest rates.** That way you can reduce your monthly mortgage payments to free up cash for other purposes. Another option might be to borrow against your home equity to get extra cash. If you have built enough equity in your home, you can take cash out to use toward other financial goals, like making home improvements, starting a business, paying for education or saving for retirement. You can also save your equity and build wealth over the long term.

Making financial decisions can be difficult. How do you know whether you should refinance for different rates or terms, or tap into your home equity? There are many options with various trade-offs

for either decision — refinancing for different terms or borrowing against your home equity. Making the right choices for you depends on your finances, goals and values.

Determining Your Financial Goals

The first step in deciding whether to refinance your existing mortgage loan for different terms or to borrow against your home equity is to consider your financial goals as they relate to your home as a financial asset. Goals state what you want to do or achieve. Setting specific financial goals helps you decide how best to use your resources. Since setting goals and allocating resources to meet those goals often require compromise among family members, it is best to involve everyone in the household in the planning process.

Start by discussing your goals as a family. Ask everyone in the household to make a separate list of financial goals. Then compare the goals and combine them into one list, deciding which ones are personal and which ones are for the household. Sample goals are:

- Reducing expenses to have more money left over each month.
- Paying off **debt.**
- Accumulating reserves in a savings account for life crises.
- Buying a car.
- Saving for retirement.
- Saving for education for yourself .
- Saving for education for your children.
- Purchasing big-ticket items, such as a boat.
- Going on a vacation.
- Starting a business.
- Making **home improvements,** remodeling or building an addition.
- Increasing your net worth.

Be specific and realistic about your goals. Being clear about what you are trying to accomplish can motivate you to change your spending habits. Consider how much money and time are needed to reach each goal. Some goals are short-term and can be reached within one year. Buying a car and saving for a family vacation may be short-term goals. Long-term goals that take more than a year to accomplish might be saving for your children's education or your retirement. After you have listed your short- and long-term goals, prioritize them. Try to get everyone in the household to agree on the most important goals you plan to accomplish together.

Because your money and assets are limited resources, it may be difficult to satisfy all of your financial goals at once. Setting goals often requires trade-offs, where you have to choose to give up something in order to get something you want more. For example, if you have equity in your home and you choose to borrow against it to go on vacation, you slow down the opportunity to build wealth through your home equity. Setting the right goals and allocating the right resources for you depends on your money, assets, liabilities and values. If your goal is to buy a big-ticket item, borrowing against your home equity is one option. Another option would be leave your home equity alone. Instead, you could save a certain amount of money over a period of time until you have enough set aside to make the purchase. Or you may be able to get a consumer loan to buy the item sooner. If your goal is to reduce your regular expenses, refinancing to change your mortgage terms is one option. Or you might opt to alter your spending habits to trim other expenditures. When it comes to refinancing your loan for different terms or borrowing against your home equity, you will likely face temptations to treat it like easy money. Think carefully about all of your options before proceeding. As already mentioned, there may be other ways to achieve your financial goals

If you are considering either refinancing your loan for different terms or borrowing against your home equity, this guide helps you understand some of the important considerations. Making trade-offs is difficult. Ultimately, you have to make financial choices for yourself based on what you want now and what you think you may want in the future. Take the time to weigh all of your options carefully. Making smart mortgage financing decisions today and throughout your life will protect your investment and help you build wealth.

The worksheet on the next pages can help you set your financial goals, analyze your existing resources, and help you make the best choice to reach your goals based on available resources, your values and each of your option's trade-offs.

Financial Goals Decision-Making Worksheet

1. What are your values?

   Review each statement, and check the column that best describes how you feel about it.

Statement	Strongly Agree	Agree	Disagree	Strongly Disagree
I want to be totally debt free as soon as possible.				
I plan to use my home to pay for my children's education and other expenses.				
I believe there is a difference between "good" debt and "bad" debt.				
I see my home as part of my overall financial portfolio.				
I see my home primarily as the place I live, not an investment.				

2. What are your financial goals? *Rank in priority order, using 1 as the top priority and 14 as the lowest. Then circle your top three priorities.*

____ Reduce expenses to have more money left over each month

____ Pay off debt

____ Accumulate reserves in a savings account for life crises

____ Buy a car

____ Save for retirement

____ Save for education for myself

____ Save for education for my children

____ Purchase a big-ticket item, such as a boat

____ Go on a vacation

____ Start a business

____ Make home improvements, remodel or build an addition

____ Buy a second home

____ Increase my net worth

____ Other: ____

3. What are the estimated costs of your top three financial goals?

Priority	Estimated Total Cost
1.	$
2.	$
3.	$

4. Which of the following financial assets and liabilities do you have now? *Check all that apply.*

Monthly Income

☐ Salary and wages: $________________________

☐ Tips, overtime, etc.: $ ______________________

☐ Public assistance: $ ________________________

☐ Social security: $ __________________________

☐ Investment income: $______________________

☐ Other: $________________________________ Total: $ ______________

Monthly Expenses

☐ Mortgage: $____________________________

(Add in taxes and insurance if not included)

☐ Food and eating out: $ ___________________

☐ Utilities: $ _____________________________

☐ Car and/or transportation: $ ______________

☐ Credit cards: $ __________________________

☐ Other: ________________________________ Total: $ ______________

Which is larger? ☐ Income ☐ Expenses

Which do you expect to increase faster? ☐ Income ☐ Expenses

Savings and Assets

☐ I have a savings account (passbook, certificate of deposit or money market), valued at

$ __________________ .

☐ This is at least three times my monthly expenses.

- ☐ I have home equity, valued at $ ______________ .
  - ☐ How much do you think your home would sell for on the market today? $ ___________
  - ☐ How much do you still owe on your mortgage? $ ______________
  - ☐ How long do you plan to stay in this home? _________ years

- ☐ I have other assets (investments, annuities, savings bonds or retirement accounts), valued at $ _____________ .
  - ☐ These are assets I do not plan to access for at least 10 years.

5. What are the trade-offs for each relevant option to meet your financial goals in relation to your resources? *Review the different ways to reach your financial goals listed below, and consider the impact of each option. Circle the trade-offs for each relevant option. Skip any options that are not applicable. For instance, if you were to refinance at a lower rate, would your new payment make your monthly expenses better or worse, or would there be no change in your monthly expenses?*

Ratings: Better ⇑ No change — Worse ⇓

	Monthly expenses	**Net home equity**	**Savings**	**My spare time**
Refinance at lower rate	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Refinance to convert one loan type to another	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Refinance to lengthen term	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Refinance to shorten term	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Obtain a cash-out refinance loan	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Obtain a home-equity loan	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Obtain a home-equity line of credit	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Obtain a reverse mortgage (for senior citizens)	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Spend “cash” savings	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Spend or borrow against retirement savings	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Sell investments	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Get an unsecured personal loan	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓
Use a credit card	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓	⇑ — ⇓

6. What is the best option for you to meet your financial goals?
Look at the top three priorities you circled in question #1, the costs of your top three financial goals estimated in #2, your financial resources listed in #3, and then your responses for each of your relevant options in #4 to answer the following questions.

How do these choices feel to you? ☐ Hard ☐ Easy ☐ Confusing

Why? ____

____

____

Are these good trade-offs for you? ☐ Yes ☐ No

Why? ____

____

____

Do they match your values now?

Priority 1: ______________________ ☐ Yes ☐ No

Priority 2: ______________________ ☐ Yes ☐ No

Priority 3: ______________________ ☐ Yes ☐ No

Do you think this will be a good decision in one year? ☐ Yes ☐ No ☐ Unsure

Why? ____

____

____

Do you think this will be a good decision in five years? ☐ Yes ☐ No ☐ Unsure

Why? ____

____

____

Do you think this will be a good decision in 20 years? ☐ Yes ☐ No ☐ Unsure

Why? ____

____

____

Section 2: Understanding If Refinancing for a Better Rate or Different Terms Is Right for You

What Is Mortgage Refinancing?

Mortgage refinancing is the process of taking out a new mortgage and using the money to pay off your current mortgage. It includes many of the same steps, and some of the same expenses, that were involved in applying for and getting the mortgage to purchase your home in the first place. The main distinction between your purchase loan and a refinance mortgage is that no property ownership is transferred during the refinance transaction.

Is Refinancing for a Better Rate or Different Terms Right for You?

Even though most mortgage loans have 30-year terms, most borrowers keep their mortgage loans for only five to ten years. Some pay off their mortgages when they sell their homes, and others refinance their loans for a variety of reasons. A key advantage of being a homeowner is the ability to change your mortgage terms through refinancing as changes occur in your financial needs or mortgage rates.

After becoming a homeowner, you may consider adjusting your mortgage payments or terms by refinancing because your financial situation, mortgage rates, or both have changed. How do you know if refinancing your mortgage loan for different terms makes sense for you? This can be a difficult decision, as it requires time, money and careful decision-making. Refinancing for different terms can be worthwhile, but it may not make sound financial sense for everyone.

If the rates or terms of mortgage loans available now are better than the rates and terms of the mortgage you have, refinancing can save you a significant amount of money. Refinancing is most likely to make sense for you if your existing mortgage has an interest rate that is higher than today's interest rates. You may want to refinance, however, for reasons other than just lower interest rates. You may want to convert an **adjustable-rate mortgage** (ARM) to a **fixed-rate mortgage,** or vice versa. Or you may want to convert to a mortgage with a shorter **loan term** to build up your equity faster and own your home outright sooner.

Today there are many good reasons to refinance to change the terms of your mortgage. Evaluating whether or not to refinance involves several steps, which you can do yourself or with the help of a reputable housing counselor:

- Set clear refinancing objectives based on your financial goals.
- Review your loan documents for the details of your current loan.

➢ *Important Note About Refinancing to Save Money on Interest Rates*
In most cases, a lower interest rate will translate to a lower monthly payment. However, some refinance loans have high fees and extra charges that are financed into the loan, increasing your loan balance and your monthly principal and interest payment. When shopping for your refinance loan, look carefully at loan fees, other costs and what the monthly payments will be.

➢ *Important Note About FHA and VA Streamline Refinancing*
FHA and VA mortgages have a unique feature called streamlining. If you have an FHA or a VA loan and interest rates drop, you can refinance without an appraisal, credit check, income verification or qualifying ratios. "Streamline" refers to the limited documentation and underwriting required by the lender. The funding fee for a VA streamline refinance is .5 percent. For a FHA loan, lenders may offer **streamline refinances** in several ways, such as with no out-of-pocket expenses to you in exchange for a higher interest rate or with the closing costs included in the new loan amount if there is enough equity in the property. For more information, see section 5, *Understanding How to Shop for the Right Lender and Loan.*

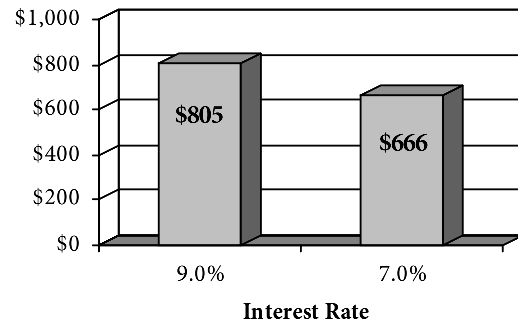
- Research available refinance loan products.
- Add up the costs and benefits of refinancing. If the benefits exceed the costs, it probably makes sense to refinance. If costs exceed benefits, it probably does not.

This section will help you determine whether or not refinancing makes sense for you at the present time. Keep in mind that you can refinance your loan more than once if your situation changes again.

Refinancing to Save Money on Interest Rates

If the interest rate on your existing mortgage is higher than what is currently available in the market, refinancing might make sense for you. Refinancing at a lower rate could reduce your monthly payments and the total amount of **interest** that you pay over the life of the loan. For example, if you had a $100,000 mortgage with a 9 percent interest rate, your monthly principal and interest payments would be $805. If you refinanced the $100,000 at 7 percent, your new principal and interest payments would be $666, or a savings of $139 per month or $1,668 per year. Lowering your payments would free up money for other financial goals, like saving for retirement or reducing your credit card debt. If you plan to stay in your home for several years, the benefits you will gain from lower monthly payments may make good financial sense. However, refinancing does cost money, so you must decide if the savings you will accumulate during the time period you plan to stay in your home are enough to justify the costs.

Monthly Savings on Refinancing a $100,000 Mortgage for a Lower Rate



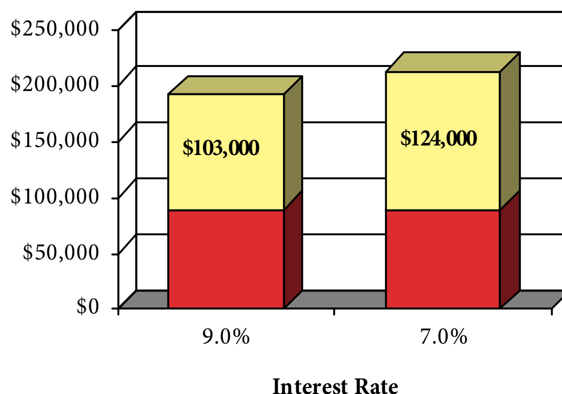
The old rule of thumb used to be to wait until interest rates drop at least two percentage points below the rate of your mortgage before you refinance. Now, however, many lenders offer no-cost and low-cost refinancing packages (costing approximately $500) that reduce or even eliminate your out-of-pocket expenses by charging slightly higher rates or including some of the costs in the amount that is financed. With these newer programs, it can be worth your while to refinance to obtain a smaller reduction in interest rates.

An important factor in determining whether or not to refinance as it relates to saving money on interest rates is your **break-even point,** or how long it would take to recoup the total costs of refinancing, including closing costs, fees, points and prepayment penalties. In general, the larger the difference between the new interest rate and the rate on your existing loan, the shorter the break-even point, while the more it costs to obtain the new loan, the longer the break-even point.

If your new loan's term is close to the unexpired term on your existing loan, calculating your break-even point is easy. You simply divide the total cost of a new loan by the monthly savings on your principal and interest payments. Let's take another look at the example provided above. The savings of refinancing a $100,000 mortgage from a 9 percent interest rate to a 7 percent rate was $139 per month. If it were to cost $2,000 to refinance, the break-even point would be just over 14 months ($2,000 ÷ $139 = 14.4). You will want to compare your break-even point to how long you plan to stay in your home, and evaluate whether or not it makes sense for you to refinance. It generally makes sense to refinance for a lower interest rate if you can recover your costs and make a decent return on your investment before you plan to sell your home or pay off your mortgage.

If you choose to extend your new loan's term beyond the unexpired term of your existing loan, you may take longer to own your home outright and end up paying more in total interest charges in the long run. That is because when you refinance, you start over in paying off your mortgage. Using the example above, let's assume that you have already made payments for 10 years on your existing 30-year loan of $100,000 with a 9 percent interest rate. At that point, your loan balance would be about $89,000. If you kept your existing mortgage, your total interest charges for the remainder of the loan term would be approximately $103,000. If you refinanced your loan balance of $89,000 at a 7 percent rate for another 30-year loan term, your total interest charges would be approximately $124,000. If you plan on staying in your home for the entire loan term, the lower payments might not justify the longer term, as you would wind up making loan payments on your home for an additional 10 years and paying an additional $21,000 in total interest charges.

Total Interest Paid on Refinancing a $100,000 Mortgage for a Lower Rate with a Longer Term



➢ *Important Note About Comparing Monthly Payments*
If you are interested in lowering your monthly payments, make sure you understand what is included in the payments for any loan you are considering. Some lenders offer loans with payments that appear to be less than those for your existing mortgage by not including money for taxes and insurance in the payments. It is important that you look for a loan with payments that include the same items — principal, interest, taxes and insurance — as your previous loan so you can get an accurate picture of what your new payments will be as well as your monthly savings.

Refinancing to Lower Your Monthly Payments

If interest rates are flat and you are looking for ways to reduce your regular expenses, there are two ways you can lower your **mortgage payment.** You can extend the term on your loan to lower your payment by switching from a 15- to 30-year term. Instead of paying off your home and owning it in 15 years, you would now own it in 30 years. The trade-off is higher overall interest charges and total costs associated with the loan.

Another way to lower your payment is to switch from a mortgage program with **principal** and interest payments to one that allows interest-only payments. The trade-off is that none of your mortgage payment will be used to pay down the principal balance of your loan, meaning that the only way you can build equity is through home **appreciation.** If homes in the area are generally not increasing in value, you most likely will not build any equity. Or worse, you could owe more on your home than it is worth if homes in the area decrease in value.

Refinancing to Convert One Type of Mortgage to Another

The type of mortgage loan you selected to purchase your home may no longer be the best financing option for your financial situation today, and you may want to consider refinancing to obtain a more suitable loan product.

Refinancing to eliminate the risk of a fluctuating interest rate.
ARMs offer lower initial rates for a specific period of time, such as two, five or seven years, but payments and interest rates can increase after the "teaser" rate has ended. If you chose an ARM for its initial lower interest rate, but now your rate and payments have risen, or are about to increase, and you plan to stay in your home for a while, it may make sense for you to look at other loan options. If your ARM has a current rate that is near or higher than prevailing rate for a fixed-rate loan, you may decide to change to a fixed-rate mortgage for predictable monthly payments. Even if the rate on a new fixed-rate mortgage is a little higher than your current ARM, you may opt to change for the security of a fixed rate if you can afford the up-front costs of refinancing and the higher monthly payments. Some ARMs have a convertibility feature that allows you to convert your ARM to a fixed-rate mortgage by paying a small fee, usually one **point** (one percent of the loan amount), which may be a cheaper option than refinancing. Before you decide to refinance your ARM to a fixed-rate mortgage, check your **promissory note** to see if it has a convertibility feature and what the rate and fees would be.

➢ *Important Note About When Mortgage Insurance May Be Required*
Generally, when you have a conventional or FHA first mortgage loan with a **loan-to-value** (LTV) above 80 percent of the appraised value of the home, your lender will require mortgage insurance. If you refinance and get a conventional or FHA first mortgage loan with an LTV that is greater than 80 percent, you will have to pay for mortgage insurance as part of your monthly mortgage payments. Generally, the higher your loan's LTV, the higher your monthly mortgage insurance payments will be.

There are many different types of ARMs, and some ARMs lack important consumer protections such as rate and payment **caps.** If you have an ARM that does not have the features you need, another option is for you to convert your existing ARM to a different ARM with lower rates or more desirable features, such as lower caps, a slower moving **index,** or a smaller **margin** to save money or feel more financially secure. For more information on typical features of ARMs, see section 5, Understanding How to Shop for the Right Lender and Loan.

Refinancing to eliminate a large balloon payment.
A **balloon-payment mortgage** is a type of short-term loan that offers relatively low monthly payments. The monthly payments are based on a 30-year **amortization** schedule, but then the entire loan balance matures in a period of five, seven or 10 years. You might have gotten a balloon-payment mortgage if you thought you would be staying in your home for a short period of time and selling it before the balance of your loan became due. However, if you have a balloon-payment mortgage that is coming due in the near future, and you lack the funds to pay the loan off and do not want to sell your home, you will need to refinance for a different type of loan to secure long-term financing for your home.

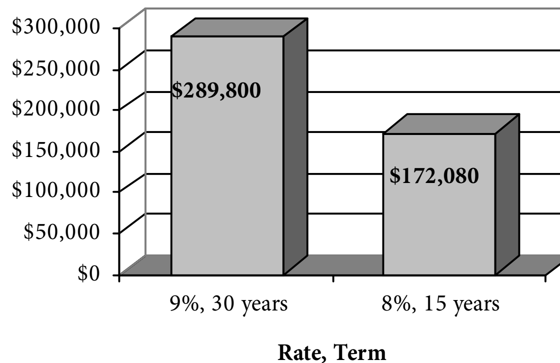
Refinancing to improve terms on a ***second mortgage.***
An **80/20** loan is a type of combination, or piggyback, financing for borrowers who lack the funds for a large down payment and wish to avoid paying **mortgage insurance.** If you chose this type of financing, you closed on two mortgage loans at the same time. The first mortgage was for 80 percent of the home's price, and the second mortgage was for the remaining 20 percent. There are a variety of options for the second mortgage. The interest rate on the second mortgage is usually higher than the rate on the first mortgage and does not carry a 30-year term. If you have an 80/20 loan with a high rate or otherwise undesirable second mortgage that you wish to replace, you may have two options, depending on your situation. The first is to refinance the second mortgage loan into a new second mortgage loan with more desirable features. The second is to replace both your first and second mortgages with a new first mortgage that is large enough to pay off both loans, if you have built enough equity in the home to avoid private mortgage insurance. One advantage of this option is having only one payment to make each month. A disadvantage may be the cost of refinancing. To decide which option is best for you, compare the costs of a new second mortgage with the costs of a new first mortgage that would pay off both of your existing loans (including mortgage insurance payments if applicable). If you obtained a second mortgage from a special loan program that offered low rates for second mortgages, you might be better off keeping the two loans you already have.

➤ *Important Note About Biweekly Mortgages*
Another way to build equity faster without refinancing is to ask your loan servicer to restructure your existing mortgage into a **biweekly mortgage**. You will likely have to pay some additional fees and expenses to do so. With a biweekly mortgage, you make payments every two weeks instead of monthly. This results in one extra payment per year, so you end up paying off your loan in less than the original term and saving money on total interest charges. Keep in mind that you can realize similar savings on your own by making additional principal payments on your loan. A biweekly mortgage can reduce your financial flexibility by making the additional payments contractual rather than optional.

Refinancing to Build Equity Faster

If your financial resources have increased since you got your mortgage, you may want to convert to a mortgage with a shorter term, such as to 15 years from 30 years. Your monthly payments may be higher, but more of your payments will be applied to pay down the principal. Thus, you will own your home sooner and pay less interest over the long run. Normally interest rates on 15-year loans are lower than rates on 30-year loans. Plus, if interest rates have dropped below what you now pay on your 30-year loan, your monthly payments on a new 15-year loan may not increase by all that much. For example, if you had a $100,000 mortgage with a 9 percent interest rate and a 30-year term, your monthly principal and interest payments would be $805 and the total interest paid over the life of the loan would be $289,800. If you refinanced the $100,000 at an 8 percent interest rate with a 15-year term, your new principal and interest payments would be $956 and the total interest paid over the loan would be $172,080. That is a savings of $117,720 in interest paid over the life of the loan.

Total Interest Savings on Refinancing a $100,000 Mortgage for a Shorter Term



Keep in mind, however, that you may be able to build equity faster without refinancing by voluntarily including some extra money with your regular monthly mortgage payments. This money will be applied directly to principal to reduce your outstanding loan balance. This is called **prepayment.** Prepayment reduces your loan term and lowers the total interest owed over the life of the loan. Just adding just an extra $50 a month to your monthly payment on a $100,000, 30-year loan at a 7 percent interest rate would reduce your loan term by more than five years and save you around $32,000 in total interest paid. If you are interested in prepaying your mortgage, contact your loan servicer to find out the proper procedures for doing so.

Important Considerations When Thinking About Refinancing a Mortgage for Better Rates or Different Terms

If your financial goal is to change or improve your existing loan terms, and you are trying to decide whether or not it makes sense for you to refinance right now, there are a variety of things for you to consider about the costs and benefits of refinancing. Although the interest rate may be an important factor in your decision to refinance, the following is a list of additional considerations:

➤ *Important Note About Prepayment Penalties*

Some lenders charge a fee for paying off your mortgage early called a **prepayment penalty** or fee. A typical prepayment penalty ranges from one to three points on the remaining principal balance if you repay through refinancing your mortgage within the first three years of the loan. To find out if your loan has a prepayment penalty, look at your **Truth-in-Lending statement** and/or the promissory note you received at closing. If your existing mortgage has a prepayment penalty clause, you will need to consider that fee as an additional cost of refinancing or wait until the prepayment penalty period is over before refinancing.

Source: *The Mortgage Kit*, Fifth Edition, by Thomas C. Steinmetz, 2003.

Personal Considerations

- How long do you plan to stay in your home? Refinancing generally makes sense when you plan to keep your property long enough to recapture the costs of refinancing.
- Are you anticipating any personal and financial changes in the near future? Before you invest in making any changes to your mortgage financing, consider your long-term needs as well as any short-term gains. Is refinancing the only or best way to accomplish your goals?

Financing Considerations

- Are rates lower? Lower rates are not the only reason to refinance. However, they can provide an extra incentive when you are looking to change other terms and features about your loan.
- How will refinancing affect your payments? If your payments will be higher, make sure you can afford them by preparing a realistic spending plan.
- What are the costs of refinancing? Be sure to consider **closing costs,** points, fees and prepayment penalties, and how you intend to pay for these costs.
- Does your lender offer any perks for refinancing? Your current lender may be able to waive or reduce certain closing costs and other fees involved in refinancing or offer quicker approval since you are already an established customer. For example, your current lender may offer to do an expedited **appraisal,** which costs much less than a full appraisal. Be sure to shop around to make sure your lender's rates are competitive with other lenders.

Equity Considerations

- How much equity do you have in your home? Your home may have appreciated in value and it may now be possible for you to avoid private mortgage insurance with a new mortgage loan that has a loan-to-value of less than 80 percent of your home's appraised value.

- How will refinancing affect your home equity? You may have the option of financing your upfront costs when you refinance. The costs are added to the mortgage, which increases your loan balance and reduces your equity.

- What is the trend with property values in your area — are they are increasing, decreasing or staying about the same? If they are increasing, you may be able to build equity more quickly with a lower interest rate and/or a shorter loan term.

Other Considerations

- How will refinancing affect your tax deductions? If you refinance at a lower rate and itemize your deductions, you will have less mortgage interest to deduct. However, you will be paying less in monthly mortgage payments, which may give you greater savings than your mortgage interest deductions did.

- Do you have a second mortgage? Refinancing only a first mortgage when you have two mortgages in place can be difficult, as it generally requires **subordination** from the second mortgage lender. With multiple mortgages, the earliest recorded loan is the one in first position. Thus, when you have two mortgages and only refinance the first one, your second mortgage becomes the earliest recorded loan on your home and can move into first position. However, most lenders want to make sure that their loan is recorded in "first position" on the title to your home. That way if you **default** on your mortgage and your home is sold in foreclosure, the loan that is in first position will be paid off first. Any remaining proceeds from the foreclosure sale will be used to pay off the junior (second or third) mortgages. A lender refinancing your first mortgage will typically not want to take the risk of being in second position. In such cases, it may be possible to have the lender on your second mortgage agree to subordinate its position and allow the lender who is giving you the refinance loan to be in first position. If your second mortgage lender is not willing to subordinate, you may have to apply for a refinance loan that is large enough to pay off both your mortgages in order to have the loans properly recorded.

The basic worksheets on the next page can help you decide if refinancing is right for you based on various considerations, such as your break-even point, how long you plan to stay in your home and your reason for refinancing. You may need the following information, depending on your reason for refinancing:

- Your current interest rate, loan balance and term.

- The interest rate and term for a new loan.

- Your approximate refinancing costs, including closing costs, fees, points and prepayment penalties.

- How long you plan to stay in your home.

➢ *Important Note About Mortgage Modification vs. Refinancing*

Loan modification is where your lender agrees to change the terms of your existing loan, often by lowering your interest rate, without requiring you to refinance. Only a small number of mortgages can be modified, and the lender will usually charge a fee of several hundred dollars. Modifiable loans are most likely to be offered through portfolio lenders, such as many credit unions, who keep loans on their books instead of selling them on the secondary market.

The difference between a **loan modification** and a refinance is whether or not you are getting a new loan. When you modify a mortgage, you keep repaying the same loan. When you refinance, you take out a new loan.

If your **lender** sold your loan, you may still be eligible for a special deal for refinancing with the same company. Call your **loan servicer's** customer service number, located in your payment book or on your monthly statement, to see if there are any special arrangements for existing loan customers.

Source: "Mortgage Modification, Easy Refis Available," www.bankrate.com, by Holden Lewis, July 3, 2002.

Worksheet for Refinancing to Save Money on Interest Rates

Costs	Current Mortgage	Refinance Loan
A. Loan amount	1.	2.
B. Interest rate	1.	2.
C. Monthly principal and interest payment amount	1.	2.
D. **Tax rate** (see page 18 for 2005 tax rate schedules)	1.	2.
E. After-tax payment amount [C x (1–D)]	1.	2.
F. Difference in after-tax payment amounts (E1–E2)		2.
G. Total closing costs		2.
H. Months to break even (G2 ÷ F2)		2.
I. How long you plan to stay in your home in months (years x 12)		2.
J. Total savings (F2 x I2)		

Worksheet for Refinancing to Build Equity Faster

Costs	Current Mortgage	Refinance Loan
A. Loan amount	1.	2.
B. Interest rate	1.	2.
C. Monthly principal and interest payment amount	1.	2.
D. Loan term in months (years x 12)	1.	2.
E. Total interest paid for loan term [(D x C)–A]	1.	2.
F. Difference in total interest paid (E1–E2)		

For more detailed and varied calculations, see the following mortgage refinance calculators online:

- Refinancing to save money on interest rates:
  www.decisionaide.com/mpcalculators/refinancingonemortgage/refii.asp
- Refinancing to convert an ARM into a fixed-rate mortgage:
  www.decisionaide.com/mpcalculators/refiarmtofrm/refiarmtofrm.asp
- Refinancing to convert two mortgages into one new mortgage:
  www.decisionaide.com/mpcalculators/refinancingtwomortgages/refi2.asp
- Refinancing to build equity faster:
  www.decisionaide.com/mpcalculators/investinginashorterterm-frm/frm30v15.asp

2005 Tax Rate Schedules

Filing Status: Single

Income Range	Tax Rate
$0 to $7,299	10%
$7,300 to $29,699	15%
$29,700 to $71,949	25%
$71,950 to $150,149	28%
$150,150 to $326,449	33%
$326,450 to no limit	35%

Filing Status: Married Filing Jointly or Qualifying Widow(er)

Income Range	Tax Rate
$0 to $14,599	10%
$14,600 to $59,399	15%
$59,400 to $119,949	25%
$119,950 to $182,799	28%
$182,800 to $326,449	33%
$326,450 to no limit	35%

Filing Status: Married Filing Separately

Income Range	Tax Rate
$0 to $7,299	10%
$7,300 to $29,699	15%
$29,700 to $59,974	25%
$59,975 to $91,399	28%
$91,400 to $163,224	33%
$163,225 to no limit	35%

Filing Status: Head of Household

Income Range	Tax Rate
$0 to $10,449	10%
$10,450 to $39,799	15%
$39,800 to $102,799	25%
$102,800 to $166,449	28%
$166,450 to $326,449	33%
$326,450 to no limit	35%

For updated schedules, see www.irs.gov.

SECTION 3: UNDERSTANDING IF CONVERTING EQUITY TO CASH IS RIGHT FOR YOU

What Is Home Equity?

Home equity is the difference between what your house is worth and the amount you owe on your home, including all mortgage loans and other **liens,** such as for unpaid **property taxes** and judgments that have been recorded against your property. For example, if the current value of your house is $100,000 and your mortgage loan balance is $80,000, your home equity would be $20,000. You can build home equity by paying down your loan balance through regular monthly mortgage payments or having the value of your home increase from making home improvements or due to rising local property values.

How Can You Use Equity Without Selling Your Home?

Your home equity is an asset. As your home equity grows, you are building your financial future. As your financial needs change you have the option of converting your home equity into cash by replacing your old mortgage with a new, larger one or getting a second mortgage, which leaves your first mortgage in place. The loan products that allow you to borrow against your home equity are described below.

- A ***cash-out refinance*** loan allows you to borrow more money using your home's value as collateral by replacing your old mortgage with a larger one. The additional cash can be used for any purpose. Often, the interest rate for a cash-out refinance is higher than the rate for the loan that is being paid off.
- A ***home-equity loan*** is where you borrow a set amount of money as a second or junior lien secured by your home's value; your **first mortgage** remains in place and stays unchanged. Second mortgage loans generally have fixed interest rates that are higher than first mortgages and are fully amortized over 10 to 30 years. Some home-equity loans, however, have balloon payments due in five, 10 or 15 years.
- A ***home-equity line of credit*** is a specialized form of a second lien, where the balance can go up or down and the interest rate is usually variable. A credit line acts somewhat like a credit card. You are approved to borrow up to a certain amount of money in small or large amounts as you need it, rather than all at one time. Usually, the lender gives you a checkbook at closing to make draws whenever you want additional money. You pay interest only on the amount you actually borrow, and normally pay back the loan monthly.
- A ***reverse mortgage,*** *or home equity conversion mortgage (HECM),* is available only if all the owners on the **title** to the home are at least 62 years old. A reverse mortgage works like a home-equity line of credit, except that you do not make any payments on the loan balance as long as you are living in

➢ *Important Note About Reverse Mortgages*
If you are eligible for a reverse mortgage, find out more about the process and choose your loan very carefully. Before you make any decisions, set up a meeting with a certified reverse mortgage counselor. You can find a list of qualified HECM counseling agencies at the HUD Web site, www.hud.gov/offices/hsg/sfh/hecm/hecmlist.cfm.

the home. You can draw down funds from the reverse mortgage in one of three ways: regular installments, a lump sum payment, or a line of credit. Unlike the loan balance of a regular mortgage, which decreases with each monthly payment, the loan balance of a reverse mortgage increases over time. A reverse mortgage loan's principal increases with each payment received, and interest and other charges accrue each month on the total funds paid out. The amount is generally not repaid until after you leave or sell the home, or the home passes into an estate. The maximum you or your estate will have to pay the lender when the home is sold is the value of the home, regardless of how much is actually owed to the lender. If the loan balance is less than the sales prices, you or your heirs will be able to keep the difference. If you would like more information about reverse mortgages, please visit AARP's Web site at www.aarp.org/money/revmort.

Choosing the right loan product for you depends on a number of factors, including what you plan to do with the extra money, how much you need and how quickly you plan to repay the money. When you are converting your equity to cash, you are borrowing more money, not saving money. Your new monthly payments will probably be higher, and your interest rate may also be higher. This section will help you determine when it might make sense for you to convert your home equity to cash and which loan product would be the best option for you to do so.

➢ *Important Note About Using Home Equity to Pay for Home Repairs*
If you plan to draw on your home equity to pay for home repairs, be sure to understand all your options before proceeding. If you have a home warranty or manufacturer warranties for major appliances or fixtures, the repairs may be covered under those policies. Repairs required due to damage from fire or storms may be covered under your homeowners insurance policy. If you own a condominium, certain repairs may be covered by your homeowners association's insurance policy. Finally, there may be programs available through a local nonprofit or government agency that offer small grants or low-interest loans to help you make certain home repairs, such as a new roof, furnace or windows.

Is Converting Home Equity to Cash Right for You?

How you choose to handle your home equity is a very personal decision. Home equity gives you the opportunity to access extra money for major financial events by borrowing against it. However, by doing so, you could jeopardize your financial security if you do not borrow wisely, reducing your home equity and increasing your debt load. It is up to you to decide how much mortgage debt is reasonable for you based on your goals, finances, comfort level and other options available to you to reach your goals.

Ideally, you should view your home equity as an opportunity to invest your money safely and wisely for long-term goals, not as an opportunity to do consumer spending. For example, if you invest your equity in home improvements, your property value may increase and you will continue building assets. If you spend the equity on luxuries — like going on a family vacation or shopping spree or buying a new, high-end car — you are just building more debt. Even though the interest rate on a mortgage loan may be lower and the money paid in interest on the mortgage loan may be tax-deductible, the total amount paid in interest may be substantially greater than it would be on other short-term financing options for luxury items.

Deciding to borrow against your home equity is not easy. Review your financial goals and analyze whether borrowing against your home equity is the right option for you to meet any of your long-term financial goals. There are some sound reasons for you to convert some of your equity to cash, but first you need to determine your financial wants and needs and consider the pros and cons of all your financing options. Before you proceed with taking on more mortgage debt, speak with a reputable housing counselor to see if borrowing against your home equity is the right choice for you to meet your financial needs. Common reasons for converting equity to cash include:

- *Making home improvements.* Most homeowners eventually find it necessary to repair or remodel their homes. Home improvement projects can be expensive and often require some type of financing. Some home improvements will increase your home's value more than others. Increasing your debt to make home improvements that will have a good payback can be a good investment. For a detailed account of investment returns for popular home improvement projects, see Remodeling Online Magazine's annual "Cost vs. Value Report" at www.remodeling.hw.net.
- *Paying for education for your children.* Some homeowners use their home equity to help pay for their children's college education. Tuition can be expensive and comes with a variety of financing options. Helping pay for your children's education can be viewed as an investment in their future, as college graduates tend to earn more than those with high school diplomas.
- *Paying for education for yourself.* At some point, you may want to improve your job skills or change careers. Paying for adult education can be worthwhile, as it may increase your earning power.
- *Consolidating debt.* Some homeowners are burdened with other consumer debt from unpaid credit card balances, installment loans and medical bills. Using your equity to consolidate all of your nondeductible, high-interest consumer debts into one monthly payment that is tax-deductible may be good, but only if you can curb the spending habits that saddled you with high consumer debt in the first place. Keep in mind that you can lose your home if do not repay a refinance or home-equity loan. Refinance and home-equity loans convert unsecured debt (like credit card debt, medical bills and other unsecured liabilities) to debt secured by your home, allowing lenders to foreclose on your home if you default. Before you decide to borrow against your home equity to consolidate debt, meet with a reputable credit counselor to discuss the pros and cons of various options for reducing your consumer debt.
- *Making investments.* Some homeowners wish to increase the scale or diversity of their investments but lack the cash available to do so. Your equity may represent an opportunity for you to invest in stocks, bonds, a small business or other real estate, all of which can be risky. Most often, homeowners are interested in investing in a small business or buying investment property. Many small businesses fail. The investment real estate market can be volatile. If you plan to resell or rent an investment property and prices slide, you can lose money. If you cannot make your mortgage payments, you will lose both your home and the investment property. If you wish to tap some of your equity to make investments, only do so with relatively sound ventures whose returns are likely to be greater than the interest paid on the mortgage loan. Clearly, it makes little sense to put your home in jeopardy to finance highly risky or speculative investments.

As your home is a major financial asset, wise use of the cash extracted from your home's equity is important. When you borrow against your home equity, you are slowing down your opportunity to build wealth and increasing your liabilities. Be sure to invest your money safely and prudently.

➢ *Important Note About Consolidating Debt*

Using your home equity to consolidate debt often leads to higher total interest costs and larger amounts of total debt. If you wrap your credit card balances and other bills into a 30-year, cash-out refinance loan, you will have a longer term with lower payments and higher long-term costs. Often this means that you are still making payments on items that you no longer have or use. In addition, you may end up running your credit card balances back up to where they were previously and consider refinancing again. If you do that, you will be threatening the opportunity to build wealth through home equity.

Determining the Amount of Equity You Have in Your Home

In order to know how much equity you have in your home, you will need to know your home's market value and your outstanding loan balance. Finding your loan balance is easy — simply call your loan servicer and ask for the amount of your loan balance. Your loan balance may also appear on your monthly loan statement. However, the loan balance listed on your statement may be slightly different than the loan payoff amount, as it may not include unpaid fees or the most current interest charges.

Finding your home's value is more challenging. The most accurate — but probably unnecessary — way to do so is to hire an appraiser. An appraisal usually costs around $400 and will be included as part of a loan application. To get a fairly accurate estimate of your home's value before applying for a loan, check with your tax assessor's office or a local real estate professional. The difference between your home's value and your loan balance is your home equity. For example, if your home is valued at $150,000 and you presently owe $90,000, you have $60,000 in home equity.

Depending on the loan type and purpose, you may be limited to a specific percentage of your home's value based on your **combined loan-to-value** (CLTV) ratio. Your CLTV is the sum of all the mortgages on your property divided by the value of your home and normally ranges from 70 to 90 percent. Using the example above, let's say the loan product you choose restricts your CLTV to 80 percent. Eighty percent of a $150,000 home is $120,000. If you owed $90,000, you would be able to borrow up to $30,000 against your home equity.

Which Loan Product Is Right for You?

If you have decided that borrowing against your home equity is right for you, you now need to think about which loan product to use. Consider why you need the money, how often and for long. Below are some rules of thumb about choosing which loan product may be right for you.

- If you need a lot of money that you wish to repay over a long time period, such as for a major home improvement project, you could get a cash-out refinance loan or a long-term home-equity loan. To choose which product is best for you, compare the costs and rates of each. A long-term equity loan may make more sense when you want to keep the first mortgage in place to avoid a prepayment penalty or private mortgage insurance or because it has a low interest rate. Some lenders and contractors offer home improvement loans instead of home-equity loans. Home improvement loans dole out money to you as work on a project progresses and do not require equity, but they can be expensive and cumbersome. In most cases, a home-equity loan will cost less than a home improvement loan. And with a home-equity loan, you will not have the hassle of proving that work has been completed for a drawdown (the disbursement of loan funds) from your lender.
- If you need a large amount of money for immediate use and do not anticipate needing to borrow again in the future, perhaps to pay a large medical bill, a home-equity loan may be the best option because it usually has lower total costs than a cash-out refinance.

- If you need to pay for things that will take some time and require multiple payments, such as a large-scale home improvement project or college tuition over four years, a home-equity line of credit may be useful to you. That way you can draw down funds as you need them and only be charged interest on the money you use.

In addition to the guidelines mentioned above, there are some online resources that may help you make a decision about which home-equity loan product is right for you:

- To help you compare the total cost of a new, fixed-rate mortgage that includes "cash out" with the cost of keeping your existing mortgage and getting a new second mortgage, visit the Mortgage Professor's Calculator at www.decisionaide.com/mpcalculators/refinancetoraisecash/refitoraisecash1.asp.
- To help you figure out whether you would be better off getting a home-equity loan or a home-equity line of credit based on how you intend to use the money, visit the "Ask Bankrate" program at www.bankrate.com/brm/home-equity-advisers/loan-vs-credit.asp.

Important Considerations When Thinking About Converting Your Home Equity to Cash

If are thinking about converting some of your home equity to cash, consider some of the following questions:

- How much equity do you have in your home? Subtract your loan balance from your home's market value.
- How will borrowing more money affect your home equity? Think about how long it will take you to repay the additional money and rebuild your home equity.
- What LTV ratios do local lenders use for different loan products: cash-out refinance loans, home-equity loans and home-equity lines of credit? Maximum allowed LTV ratios are normally lower for cash-out refinancing and home-equity loan transactions than mortgages for home purchase or straight refinancing.
- How will borrowing against your home equity affect your payments? Since you are borrowing additional money, your payments will be higher. Prepare a realistic spending plan to make sure you can afford them. Be sure to anticipate any personal and financial changes in the near future.
- What interest rates do lenders charge for different loan products? Are the rates for various products fixed or adjustable? If they are adjustable, find out how often rates will be adjusted and if there are interest and payment caps. Base your decision to take an adjustable-rate loan on the maximum payment possible.
- Do any of the loan products require a lump-sum payment in the future? If so, have some realistic plan for making this payment.

- What are the up-front costs associated with different loan products? Be sure to include closing costs, points, fees and prepayment penalties. Compare these costs with the costs of alternative types of financing.
- What are the loan terms for different loan products? Keep in mind that a longer term will have lower monthly payments, but higher total loan costs.
- How will borrowing against your home equity affect your tax deductions? In addition to your first mortgage, up to $100,000 of additional mortgage debt (up to 100 percent of your home's market value) qualifies for interest deductions from your income taxes.

Home-Equity Loan Cautions

Your home is probably your largest financial asset. Proceed cautiously when considering borrowing against your home equity. Choose the right loan amount and product with the right lender for the right reasons. There is often a difference between what you qualify for and your comfort level with repayment. You do not need to borrow all of the money that is offered to you. Any money you borrow must be repaid eventually. When you borrow against the equity in your home, failure to make payments can result in losing your home.

Some lenders offer high-rate, high-LTV mortgages, where the first and second mortgages add up to 125 percent of your home's market value. If you owe more than your home is worth, you may end up trapped. Selling your home would end up costing you money because you would not be able to pay off the loan with the proceeds, meaning that you would be required to pay the deficiency with your own funds. If you could not make the payments, the only alternative would be to give up your home — losing your shelter and seriously damaging your credit.

If you think that converting some of your home equity is right for you, take your time when choosing a loan. Resist high-pressure tactics, shop around, and ask a lot of questions.

SECTION 4: UNDERSTANDING HOW TO PREPARE FOR BORROWING AGAIN

Preparing to borrow again involves many of the same activities you had to do in order to secure the financing to purchase your home. Before you meet with a lender, get your finances in order by reviewing your **credit score,** preparing a realistic spending plan and gathering your financial records.

Checking Your Credit Score

Poor credit is one of the top reasons reputable lenders turn down prospective **borrowers.** Many lenders have loans available for those with credit problems, but those loans will have higher interest rates than the loans offered to borrowers with good credit. Just as when you applied for your mortgage to purchase your home, lenders place great importance on your credit score when deciding whether to approve your loan application, as well as how much credit to extend and at what interest rate.

Credit scores are often called "FICO® scores" because most credit scores are produced from software developed by the Fair Isaac Corporation (FICO). With FICO scores, higher scores are better scores, and most consumers score between 300 and 850. FICO scores are provided by the three major **credit reporting agencies,** although they have different names and ranges at each of the three agencies:

CREDIT REPORTING AGENCY	FICO® SCORE	RANGE
Equifax	BEACON	300–850
Experian	Experian/Fair Isaac Risk Model	340–820
TransUnion	EMPIRICA	150–934

Generally, lenders consider any score over 700 to be a good credit risk and will offer such borrowers the best rates available according to market conditions. Borrowers with low scores are frequently served by loans at higher rates. If you have a low credit score and want to qualify for a better interest rate, keep in mind there is no quick fix to improving your credit score. Improving a credit score takes time. Meet with your housing counselor or a reputable nonprofit credit counselor to learn how to raise your score. For more information on credit scoring, visit www.myfico.com.

It is a good idea to order and review your own **credit reports** and credit scores before your apply for a loan. That way you can correct inaccuracies, remove old information and improve your credit record before you meet with a lender. If you have not ordered any credit reports within the last 12 months, you will be able to get free copies from all three credit reporting agencies. Request your report from www.annualcreditreport.com, by calling (877) 322-8228, or by completing the Annual Credit Report Request Form (www.ftc.gov/bcp/conline/edcams/credit/docs/fact_act_request_form.pdf) and mailing it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. The free credit

reports do not include credit scores, but you can purchase those when you request your free annual credit reports through the Web site or by contacting one of the nationwide credit reporting agencies:

- Experian: www.experian.com or (888) 397-3742
- Equifax: www.equifax.com or (800) 685-1111
- TransUnion: www.transunion.com or (800) 916-8800

Preparing a Realistic Spending Plan

You probably made a household spending plan when you were saving to buy your home, and you may have already updated it to include all the expenses of homeownership. Refinancing and borrowing against your home equity costs money, and you will want to make sure you have some savings to pay for those up-front costs. If you have a current spending and savings plan, review it prior to applying for another loan. If not, you will need to prepare one that includes all of your monthly obligations, regular expenses and money set aside for savings. A realistic spending plan is particularly important if you are borrowing more money or your new monthly mortgage payments will be higher. That way you will be able to determine if any increases in your monthly mortgage obligations will be acceptable to your lender as well as affordable to you, given your current lifestyle. There is often a difference between the payment you qualify for with the lender and the payment amount that is comfortable to you. Lenders will look at your total **debt-to-income ratio** — how much of your monthly income goes toward paying your current mortgage, credit card bills, car payment, student loan, child support and other obligations listed on your credit report, as well as the payments on any additional equity debt for which you are applying. Most conventional lenders like to see that ratio under 40 percent of your income. Keep in mind, however, that your debts are not your only expenses. You may have to pay for childcare, school tuition or medical expenses that are not reported on your credit report and usually not taken into account by your lender when determining how much you qualify to borrow. You need to be realistic about what your actual monthly expenses are so you can determine for yourself the loan amount you can afford.

If you need to prepare a spending plan, it is easy to do so. All you need to do is gather information about your income and expenses and then write down how much money you make and how you spend it and think about how you might save and spend your money more wisely. Preparing a spending plan essentially involves three steps:

- *Determine your net monthly household income,* or how much money you bring in each month after taxes and other payroll deductions have been taken out. To determine your **net income,** collect any papers that show how much money you bring in from your regular job, occasional work and any other sources like alimony, child support or disability payments. Add up all the money you receive each month.
- *Calculate your monthly expenses,* or the things you spend money on, such as your house payment, utilities, car payments, credit cards, insurance, food, clothing, childcare, gasoline, movies, sporting

events, church and charity donations, etc. To calculate your expenses, gather any materials that show bills you pay every month and add up the total amount of money you spend each month.

- *Calculate your* ***discretionary income,*** or the money that is left over at the end of the month to spend or save. To calculate your discretionary income, subtract your regular expenses from your income.

Once you see where all of your money is going, you can make changes to your spending habits to reduce your expenses and increase your discretionary income. You can use one of the many budgeting worksheets available online or in financial planning guides to draw up your desired spending plan.

Gathering Your Financial Records

Before meeting with a lender, call and ask what records you need to supply for your loan application. In addition to the same financial documents about your income, debts and savings you needed when you applied for the loan to buy your home, you will need to assemble information about your home and existing mortgage. The following is a list of information typically required by lenders when you are refinancing or borrowing against the equity in your home:

- Income tax returns and other income information;
- Bank statements;
- Payoff of existing mortgage;
- Copy of recorded deed to your home;
- **Homeowners insurance** policy;
- Most recent property tax bill; and
- Copy and description of home improvement plans if you are borrowing against your home equity to make renovations.

The checklist on the next page can help you gather your financial records prior to meeting with a lender.

Loan Documentation Checklist

General Documents

- ☐ Drivers license or other picture ID

Documents to Support Income

- ☐ Income tax returns for the last two years, including W-2s and all attached schedules
- ☐ Most recent two months' pay stubs from all sources of employment
- ☐ The name, address, phone number and fax number of every employer you have had in the last two years
- ☐ Child support payments
- ☐ Pension benefits
- ☐ Seasonal employment income
- ☐ Government assistance/SSI benefits
- ☐ Social Security benefits
- ☐ Statements of stock dividends

Documents to Support Savings and Recent Bank Activity

- ☐ Savings account statement(s) for the last three months
- ☐ Most recent checking account statement(s)
- ☐ Most recent brokerage statements showing investment balances and recent transactions

Documents Related to Existing Mortgage

- ☐ Payoff statement of existing mortgage(s)
- ☐ Copy of the recorded deed
- ☐ Most recent homeowners insurance policy
- ☐ Most recent property tax bill

Other

- ☐ Veteran's certificate of eligibility
- ☐ Certified copies of divorce decree and separation agreement
- ☐ Copy and description of home improvement plans if renovations are being made
- ☐ Letter(s) of explanation for any gaps in income or negative credit items
- ☐ Student loan repayment information

SECTION 5: UNDERSTANDING HOW TO SHOP FOR THE RIGHT LENDER AND LOAN

Refinancing your mortgage for different terms or borrowing against your home equity can be advantageous. To ensure that you get the best possible loan product from a reputable lender, it is important that you understand exactly what you are buying and how much it really costs. By shopping around and making an informed choice, you can save tens of thousands of dollars and protect your investment in your home.

Key Financing Terms

But before you start shopping, let's review some of the terms you need to understand in order to find the loan product that is right for you. These terms might sound familiar to you because they are the same terms that you learned when you were shopping for your purchase mortgage. But it may have been awhile since you bought your home, and it never hurts to have a refresher course before you refinance your mortgage.

The following terms are important to know as you are searching for your refinance or equity loan:

Principal. This is the total amount of money you borrow from a lender, not including the interest you will pay on the loan.

Loan-to-Value (LTV). LTV is the ratio of the loan balance you owe to the appraised value of your home. Typically, a lender will loan you only a percentage of the appraised value, meaning that the LTV will be less than 100 percent.

Term. The term is the total amount of time you are given by a lender to repay the money you borrow. Many refinance loans have a 30-year term, meaning that you have 30 years to pay the lender back the full amount of money you borrowed. The longer the loan term, the longer you are stretching out your interest payments. You pay more money in interest for loans with longer terms than if you paid the loan off in a shorter period of time.

Interest. This is what lenders charge you to borrow their money. Interest accumulates over time on the unpaid balance of your loan and is expressed as a percentage called the interest rate. Unlike interest for credit cards or car loans, which is not deductible on your federal or state income tax return, mortgage interest is deductible. Deducting your mortgage interest payments on your tax return may result in savings on the income taxes you owe.

***Annual Percentage Rate** (APR).* This is the total annual cost of borrowing money based on the loan amount, interest rate, added fees and term. The APR is expressed as a percentage. It includes the interest rate, points and certain other fees charged by the lender, which often makes it higher than the

➤ *Important Note About Tax Deductions*
Current law permits you to deduct all the interest you pay on acquisition and straight refinance mortgages from your total taxable income. You also can deduct the interest you pay on home equity debt of $100,000 or less.

These **tax deductions** may reduce the federal (and in most cases, the state) income taxes you owe, and could save you money. This benefit works when your itemized deductions, including mortgage interest, property taxes and other home-related expenses in a given tax year, exceed your standard deduction. Your standard deduction is a dollar amount based on your filing status that reduces the amount of income on which you are taxed. For more information, see section 8, *Understanding Your Responsibilities After Loan Closing*, and Publications 501 and 936 from the Internal Revenue Service, which are downloadable from www.irs.gov.

interest rate the lender will quote you. When looking at different loan products, the APR provides a more useful comparison than just the interest rate.

Points. A point equals one percent of your loan amount. So, if you are borrowing $50,000, one point would equal $500. Some refinance and equity loans require you to pay points. Points are generally paid at closing. There are different kinds of points: **discount points** and **origination fees.** A discount point is a prepaid finance charge. Often the lender will offer you a lower interest rate on your loan in exchange for paying discount points. Each discount point typically lowers your interest rate by 0.25 percent. An origination point is a fee charged by some lenders just to make the loan. It covers the administrative costs in preparing and evaluating your loan, and, when charged, is typically one point. The total number of points charged by a lender varies.

➢ *Important Note About Discount Points*
Paying discount points, or up-front interest, should always be optional. The key factor to consider when determining whether you want to pay points in exchange for a lower interest rate is how long you plan to own your home or keep this particular loan. If you plan to stay in your home for a long time, it may be worth paying discount points upfront to ensure lower interest rates in the long run. If you opt to pay discount points, the amount of the points should be stated clearly and reduce the loan's interest rate.
It may be possible to finance the cost of the discount points into the loan, but doing this will increase your loan amount and, therefore, your total costs over the life of the loan. This could offset any savings you would have had with the lower interest rate.

Loan Fees. These are the fees lender charges you to process, approve and make the loan. They may include origination fees, points and fees for the application, credit report and appraisal. While some loan fees may be paid at closing, others are often paid in advance, such as the fees for the credit report and appraisal. Be sure to ask your lender what each fee covers and to explain anything that is not clear to you. Keep in mind that fees vary from lender to lender, and you may be able to negotiate with lenders to pay lower fees. Below are some tips to get lower costs:

- Ask if the lender will waive any fees to get your business or if you opt out of a service. For instance, a lender may normally overnight documents back and forth for faster approval. If you are not in a hurry to close, you can ask the lender to send the documents via regular mail and drop the overnight charges.
- Ask if you really need a new title search and title insurance policy, especially if you are doing a straight refinance with your current lender. If the title search for your original mortgage was done recently, you may be to get a re-issue policy at a discounted rate.
- Ask for lower-cost appraisers, and skip surveys. If you are refinancing with your current lender, you may be eligible for a less costly, expedited appraisal. If you had a survey done recently as part of your original mortgage, you probably do not need a new one.
- Look online for typical fees and costs, and use that to leverage your lender. Watch out for "junk fees" or additional charges.

When you apply for a loan, the lender must provide you with a **Good Faith Estimate** of the settlement costs you are likely to pay, within three business days of applying for a loan. The amounts listed on the Good Faith Estimate are only estimates, so the actual costs may vary. It is a good idea to keep your Good Faith Estimate so you can compare it with the final settlement costs that will be listed on your **HUD-1 Settlement Statement.** You can and should ask the lender questions about any differences between the two.

Closing Costs. These are expenses that you incur by refinancing your home or obtaining a home-equity loan. Closing costs vary from loan to loan. Closing costs normally include:

- Charges associated with the loan. These are the fees that lenders charge to process, approve and make the loan, which are described in greater detail below.
- Government recording fees. These consist of any **document recording** fees for registering the mortgage with your local government agency when a mortgage loan is made.
- Title charges. These cover the costs for services performed by title companies and others, such as the title search and the **title insurance** policy. The title search is an examination of public records to confirm ownership of the real estate, and the title insurance policy insures the lender for a specific amount for any loss caused by discrepancies in the title to the property. On a refinance loan, lenders typically require title insurance up to the value of the loan. If the title search for your original mortgage was done in the past five to 10 years, your current title insurance company may be able to re-issue your policy at a discounted rate. Be sure to ask for this discount if applicable.

Just as with purchase mortgages, closing costs for refinance loans usually total between two and seven percent of the loan amount. That is because your refinance loan will have many of the same closing costs as your original home loan. Closing costs on home-equity loans or lines of credit may be lower, however, because lenders do not have to perform many of the same closing and underwriting steps required on first mortgages. On a home-equity loan or line of credit, you may be able to opt for a computerized property valuation rather than a full appraisal, or agree to a title search, but not new title insurance.

Closing costs are normally paid at **closing.** As you probably did when you purchased your home, you can bring a cashier's check to your closing. With refinance and equity loans, you may have two other options for how you handle your closing costs. You could finance them into the principal balance of your loan, or you could agree to a slightly higher interest rate to cover them. Keep in mind that both of these options raise the total cost to you over the life of the loan.

Escrow Account. A special account set up by your lender to pay for your real estate property taxes and homeowners insurance, and mortgage insurance if required, when they are collected as part of your monthly loan payment. Your current mortgage loan may include an escrow account to pay for your taxes and insurance.

If you do not have an escrow account, here is how it works. At the beginning of the loan and again at the beginning of every year, the lender estimates how much the taxes and insurance will cost for the year and divides the cost by 12. The lender collects the money monthly as an add-on to the mortgage and interest payment and saves it in a special account called an escrow account. When the bills are due the lender pays them.

When you refinance your mortgage, you will need to set up a new escrow account (even if you already have one with the same lender) if such a service is offered by the lender. If your lender does not set up an escrow account for you, you will need to pay those bills on your own. In such cases, it is important for you to plan for those expenses by setting aside enough money on a regular basis in a savings account

➢ *Important Note About Escrow Accounts*
Many refinance loans, especially those offered by nonprime lenders, are advertised without escrow payments. This makes a loan's monthly payments look lower, but can cause a huge payment shock when the tax or insurance bill comes due.

One of the best tools for managing tax and insurance payments is an escrow account. If an escrow account is not included with your refinance loan, ask your lender about setting one up. While establishing an escrow account requires time from the lender and an initial investment and higher monthly payments from you, it makes it easier to pay your tax and insurance bills when they are due. Keep in mind that tax bills are usually significant amounts. If you do not pay your property taxes, you can lose your home.

earmarked for taxes and insurance. Penalty fees can be high if you do not pay your property taxes or insurance when they are due.

Amortization. This is the process of reducing or "paying down" the principal of your mortgage loan by making periodic payments throughout the loan term. In most cases, loans are amortized, or repaid, through monthly payments that consist of principal and interest. When your loan is fully amortized, it will be repaid in full and you will no longer owe your lender any money.

Interest Rate Lock-In. A rate lock is a legal commitment between you and the lender, where the lender promises you a loan at a specified interest rate for a certain period of time. You may have to pay a fee to lock in your rate, especially if you wish to lock beyond 30 days. Interest rates can change frequently during the period of time that you are shopping for a loan and finally closing on one. Once you find a loan that meets your needs, it is important to ask if the lender will lock in your rate. This guarantees you the rate as long as the loan is closed within a set period of time, even if rates rise. If interest rates fall during your lock-in period, some lenders will allow your rate to float down, meaning that it will decrease with the falling interest rates, thereby saving you money. If you plan to get a loan during a period when interest rates are falling, you should make sure your loan has a float-down provision. When you apply for the loan, you should ask the lender how long it will take to close the loan. If your lock-in period expires before you go to closing, your lender is not required to offer you the same interest rate you had locked in earlier. Be sure that you lock in for a period that is long enough to cover the time until your expected closing date.

There are many things to think about when deciding what type of loan product to select when you refinance your home or borrow against your home equity. Below are some of the questions you will need to answer to ensure that you choose the best loan for you.

How Do I Choose Between a Fixed-Rate and Adjustable-rate Mortgage Loan?

There are two basic loan types: fixed-rate mortgages and adjustable-rate mortgages.

A *fixed-rate mortgage loan* has an interest rate and a monthly principal and interest payment that do not change throughout the term of the loan. Fixed-rate mortgage loan terms are typically 15 or 30 years. Whatever term you choose, a fixed-rate mortgage ensures that every month your principal and interest portions of the mortgage payment will remain exactly the same until you refinance again or until you pay off your entire loan and own your home outright. Keep in mind that property tax and homeowners insurance rates may change during the duration of the loan, and if money for taxes and insurance are collected as part of your monthly loan payment, this could affect your total monthly mortgage payment.

If you choose a fixed-rate loan, even if market interest rates rise, your principal and interest payments do not increase. At the same time, when interest rates fall, your principal and interest payments do not decrease. The predictability of your monthly mortgage payment makes budgeting and planning for other expenses easier because you always know exactly how much money you need to pay toward the principal and interest portion of your mortgage every month. Of course, if interest rates fall and you

find out that you could save a lot of money on your mortgage payments, you can always refinance again, but remember that refinancing takes time and costs money. Before you decide to refinance again, you should be sure that the savings in your monthly payments are worth these added costs.

As a general rule, the shorter the term of the loan, the lower the interest rate. So, a 15-year, fixed-rate mortgage usually has a lower interest rate than a 30-year, fixed-rate mortgage. Although shorter repayment periods have higher monthly payments, your total loan costs will be less since a larger amount of your monthly payment is applied to pay down the principal balance and you are paying interest on the borrowed money for a shorter time. Selecting a loan term involves striking a balance between how low you want your monthly mortgage payments to be versus how quickly you want and can afford to own your home outright.

An *adjustable-rate mortgage* (ARM) is a loan whose interest rate adjusts, or changes, during the loan term at specified intervals. The interest-rate adjustment is tied to an index determined by the lender. This index rises and falls as interest rates change in the market. It is important to ask the lender about the history, or past performance, of the index so you have a sense of how the ARMs have changed in the past. All ARMs have an interest rate that is fixed until the first adjustment date. Most start with relatively low interest rates and then adjust every six to 12 months, although they can adjust more often. When the rate adjusts, your monthly payment may change. If the index has risen when the time comes for a rate adjustment, your interest rate and monthly payment will also increase. Of course, if the index has fallen, your interest rate and mortgage payments can end up being less than what you have been paying, but probably not less than what you started out paying.

Many times the initial interest rate on an ARM is a "teaser rate" — a rate lower than the index used when the rate on the loan adjusts. The low introductory or beginning rate on an ARM may be attractive. But before you choose this type of mortgage, it is critical to understand two elements: how often the rate adjusts, and whether there are limits, or caps, both on each interest-rate adjustment and on the total amount of change in the interest rate allowed during the term of the loan.

There are two types of caps related to an ARM that you should ask the lender about. An adjustment cap limits the amount of change (increases or decreases) that can occur each time the loan adjusts. Adjustment caps can vary substantially among lenders. Some may set the adjustment cap at one percent, and others may set it as high as three percent higher than the initial start rate. The other type of cap, a lifetime cap, limits the total amount of interest rate change allowed during the term of the loan. Again, these can vary substantially among lenders. Without a lifetime cap, your loan could continue to increase as the interest rate rises, and this could have a dramatic effect on your budget and your ability to afford your home. Be sure that your ARM has caps in place and that you ask your lender to tell you the exact dollar amount that you will have to pay if your loan adjusts to the maximum possible payment.

When considering an ARM, it is critical that you look at your budget and understand how much you could afford to have your monthly payment increase. Think hard about whether or not you are able to afford the maximum possible payment allowed. Think about how the need to pay the maximum possible payment will affect your ability to accomplish your other financial goals. If your loan hit its

➢ *Important Note About Interest-Only Mortgages*

An **interest-only mortgage** allows you to pay only monthly interest payments during an initial period of time. Interest-only loans can have fixed or adjustable interest rates. If you chose an interest-only mortgage, your initial payments would be lower than they would be with a fully amortizing loan because they do not include principal payments. The interest rate, however, may or may not be lower than the rate you would get on a fixed- or adjustable-rate loan that does include principal payments. At the end of the interest-only period, the loan becomes fully amortizing for the remainder of the loan term. At this point, the monthly payment could rise dramatically, especially if you have an ARM whose interest rate has increased due to rising interest rates.

The greatest danger of an interest-only mortgage is that it may tempt you to borrow more money than you can realistically afford. Another danger is limited equity building. During the interest-only period, you build equity only if your home's value appreciates. If **depreciation** occurs, you could end up owing more than your home is worth.

Before you decide to choose an interest-only mortgage, visit a reputable housing counselor.

maximum, could you still afford to pay for your car, childcare or medical expenses? If you cannot afford to make this payment over a period of time, you should think very carefully about the risks to you and your family associated with taking this type of loan.

If you already have an ARM, you may choose to refinance with a fixed-rate loan when interest rates are low, so you can have a consistent and reliable low monthly mortgage payment and avoid the risk of rising interest rates in the future.

How Do I Decide Whether To Pay Discount Points on My Loan?

Whether shopping for a fixed-rate mortgage or an ARM, you need to think about whether you would prefer to pay discount points in exchange for a lower interest rate, versus paying fewer or no points in exchange for a higher interest rate. If you plan to live in your home for a long time, eventually you may save money by paying discount points in exchange for smaller monthly mortgage payments and lower total loan costs. But if you think you will be in your home for a short time, you may decide that it is not financially worth it to pay points. You may remember that when you first bought your home, you were able to get a tax deduction for the points you paid at closing during the year that you paid for them. When you get a refinance or home-equity loan, you generally cannot deduct the money you paid for discount points up-front. Instead, you deduct them over the life of the loan.

How Do I Choose Between Private and Government-Assisted Loan Products?

Refinance and equity loans fall into two broad categories: private loan products and government-assisted loan products. Not all government-assisted loan products allow you to borrow against your home equity.

Private loan products. These loans are not insured by the federal government and include conforming conventional and nonprime loans. **Conforming conventional loans,** which are often called "prime" or "A-paper" loans, meet specific eligibility criteria to be sold to **secondary market** investors. These loans are made by lenders to the most creditworthy borrowers at the prime interest rate — the best rate available according to market conditions. Lenders set their own interest rates and fees for conventional refinance loans and determine the maximum amount they will lend under each program. **Nonprime loans** have higher interest rates than conforming conventional loans. Nonprime loans are typically used by lenders to serve borrowers who cannot qualify for **prime loans** due to poor credit, unverifiable income or employment, loan size, loan position or other factors. Nonprime loans rely on what is called **"risk-based pricing."** That is, your interest rate and fees are based on your default probability and the lender's risk of loss. Your price is based on a number of factors, including your credit score, debt-to-income ratios and LTV ratios.

Government-assisted loan products. These loans are insured or guaranteed by the federal government. While government-assisted loan products may have lower interest rates and fees or more liberal qualification standards than private loan products, they typically have lower maximum mortgage amounts and very specific eligibility criteria. They also may take longer for loan approval and funding. And, as

mentioned above, not all government-assisted loan products allow for you to borrow against your home equity.

There are three primary types of government refinance loans:

- FHA streamline refinance loans are available through participating lenders to homeowners who already have an FHA-insured mortgage that is being paid on time (not delinquent). The streamline refers only to the amount of documentation and underwriting the lender requires to process the loan, and does not mean that there are no costs involved in the transaction. Lenders may offer FHA streamline refinances in several ways. Some lenders offer no out-of-pocket expenses by charging you a higher interest rate on the new loan than if you financed or paid the closing costs in cash. Others include the closing costs in the mortgage amount if you have enough equity in your home, as determined by an appraisal, not to exceed the original loan amount. The refinance results in lower monthly principal and interest payments. No cash may be taken out on mortgages refinanced using the streamline refinance process. For more information, contact a participating lender or visit HUD's Web site at www.hud.gov.
- VA refinance loans are available to eligible people on active duty and veterans of the U.S. armed forces with VA or conventional loans through participating lenders. The government has provided special benefits to veterans who want to refinance their mortgages. Regardless of whether you currently have a VA loan or a conventional loan, if you qualify, you can take advantage of VA refinancing benefits. Similar to FHA, the VA streamline refinance program is available, with a **funding fee** of one half of one percent that may be paid in cash or included in the loan, if you currently have a VA loan and simply wish to lower your rate. If you have a conventional loan and qualify to refinance into a VA loan, there is 2.2 percent funding fee. It may be possible to do a VA cash-out refinance loan if have built up some equity. More information on these programs can be found by contacting a participating lender or visiting the Department of Veterans Affairs Web site at www.homeloans.va.gov.
- USDA Rural Development, Rural Housing Service Guaranteed Rural Housing loan program offers refinancing to homeowners with existing Rural Housing Service Section 502 Guaranteed or Direct Loans who live in rural areas through participating lenders and Rural Development offices. A fee of one half of one percent applies, which can be paid in cash or financed along with other closing costs.

How to Find the Best Lender

Now that you are familiar with a variety of options to consider, it is time to search for the lender that can offer you the best refinance product. These days it is not difficult to find a lender who will loan you the money you need to refinance or borrow against your home equity. Thus, it is critical to understand exactly what the lender is offering you so you can be sure to get the very best priced loan you can. Before you choose your lender, be sure that you shop around, compare costs and loan terms, and negotiate the best deal.

As you probably remember from your experience buying your home, your credit rating will influence the loan products you will be offered. Those with good credit are rewarded with lower interest rates because they have a history of repaying their debt. Conversely, those who have had past credit problems are often charged higher interest rates to offset the possibility that they will fall behind in their payments. But do not assume that minor credit problems caused by past illness or temporary job loss limit your loan choices to only high-cost lenders. Be sure that you explain your situation to the lender and ask how your credit history will affect the price of your loan. Ask what you can do to get a better price. Take your time and find the best product you can.

If you have had a good experience with your current lender, start shopping for a loan there. Ask your lender for information on loan products, costs and terms, and compare the products to others found in your local newspaper and from referrals. You may find that your current lender has comparable rates, but lower fees. You can use the Internet to shop, but be careful about extra costs, payments without escrow accounts and your privacy. Be wary of lenders who advertise on television, knock on your door or send you offers without your asking. These offers often sound much better than they are.

It is a good idea to contact several lenders for price quotes so you can compare and contrast what they have to offer before you make a decision. Also remember that there are local nonprofit housing counseling agencies that can provide you with information and insights to assist you in your decision-making. Do not let anyone pressure you to make a decision before you are ready. See section 7: Understanding How To Avoid Predatory Lending, for more warning signs of predatory lending.

In order to compare various mortgage products, it is important to compare the same combination of interest rates, points and fees being offered by each lender. Ask each lender to tell you exactly how much your monthly mortgage payment will be and the total dollar amount you will have to pay at closing. Better yet, ask each lender for a Good Faith Estimate of your anticipated closing costs. To keep track of what you learn, use the worksheet on page 37 to enter information on each lender.

If you are dealing with a mortgage broker, be sure to ask how much commission he or she is being paid and who is paying for it — you, the lender or both. Be sure that the broker is not pushing you into a higher priced product to generate a higher commission from the lender. Again, if you do your homework and get the information in the loan comparison worksheet from at least three lenders or brokers, you should be able to tell which loan is priced best.

How Do I Select the Best Loan?

After you have completed the worksheet, you should have all the information you need to select the loan that best meets your needs. Remember to consider the total cost of your loan, not just the interest rate. Be sure you are comfortable with your decision. Do not let anyone pressure you to choose something that you do not want.

Refinance and Home-Equity Loan Comparison Worksheet

	Lender 1	**Lender 2**	**Lender 3**	**Current Mortgage**
Name of Lender				
Name of Loan Officer/Contact				
Phone Number				
Date				
Basic Information on the Loan				
Loan program (straight refinance, cash-out refinance, home-equity loan, home-equity line of credit or reverse mortgage)				
Loan amount requested				
Type of loan category (conforming conventional, nonprime, FHA, VA or RD)				
Type of loan (fixed-rate, adjustable-rate*, interest-only, balloon-payment or other)				
Loan term				
Interest rate				
Annual percentage rate (APR)				
Points				
Loan-to-value or combined LTV				
Mortgage insurance requirements (if conventional or FHA first mortgage >80% LTV)				
Estimated monthly escrow for taxes and homeowners insurance				
Debt-to-income ratio				
Estimated monthly payments for all loans				

	Lender 1	Lender 2	Lender 3	Current Mortgage
Loan Fees (Different lenders have different names for fees and may charge different fees)				
Application fee				
Origination fee				
Processing fee				
Underwriting fee				
Appraisal fee				
Credit report fee				
Document preparation fee				
Broker fee				
Other fees				
Total loan fees				
Are any of the fees negotiable?				
Are any of the fees refundable if the loan is denied?				
Other Loan Considerations				
Prepayment penalties				
Is there a prepayment penalty?				
How much is the penalty?				
How long does the penalty period last?				
Are extra principal payments allowed?				
Rate lock-in				
Is the rate lock-in in writing?				
Is there a fee?				
When does lock-in occur?				
How long will the lock-in last?				
Is there a float-down provision if the rate drops before closing?				
Credit life insurance				
Does the monthly amount quoted include an optional charge for credit life insurance?				
How much lower would the payments be without credit life insurance?				

	Lender 1	**Lender 2**	**Lender 3**	**Current Mortgage**
Balloon-payment				
Does the loan have a balloon payment?				
When is it due?				
***Adjustable-Rate Loan Considerations**				
What is the initial rate?				
How long does the initial rate last?				
How frequently does the rate change after the initial period?				
What are the rate caps for the first adjustment, each adjustment after that and over the life of the loan?				
What index will be used?				
What is the margin?				
What could the highest monthly payment be?				
Can the loan be converted to a fixed-rate?				
Cost of conversion option				
Personal Considerations				
Your credit score				
Can you afford this loan?				

Sources: Federal Interagency Task Force on Fair Lending and the Federal Trade Commission.

Section 6: Understanding the Loan Process

It can take anywhere from two to four weeks or more to get your loan approved. The major steps in the process include loan application, loan processing, loan underwriting and loan closing.

Loan Application

Once you have chosen your lender and the loan product that is right for you, you will be ready to begin the loan application process. This process gives the lender information on your ability to afford your loan payments and also on the value of the property you are refinancing. To assess your ability to repay the loan, your lender will need to have an accurate picture of you assets and debts. To ensure that your property is worth at least as much as you are borrowing, the lender will conduct an appraisal of your property.

In addition to providing the documents listed in section 4, Understanding How to Prepare for Borrowing Again, you will have to fill out the Uniform Residential Loan Application, known as the 1003, with a loan officer. It is your responsibility to make sure that all the information listed is correct. Remember that falsifying loan documents is fraud. In addition to the fact that it is not in your best interest to get a loan that you are not qualified for, it is against the law. The 1003 includes the following information:

- Type of mortgage and terms of the loan, including whether the loan is conventional, VA, FHA or other, and whether it is a fixed-rate or an adjustable-rate mortgage.
- Property information and purpose of loan, including the property address and the fact that you are refinancing.
- Borrower information, including contact information about you and the co-borrower, if applicable.
- Employment information about you and the co-borrower.
- Monthly income and housing expense information.
- Assets and liabilities, including bank accounts, retirement accounts, car debt, credit card debt and student loan debt.
- Details of the transaction, including loan amount and estimated closing costs.
- Declarations, which are potential warnings to your lender, including whether there are outstanding judgments against you and whether you have declared **bankruptcy** in the past seven years.
- Acknowledgement and agreement that everything in your application is valid and correct.

When you apply for your loan, you will probably be asked to pay for the credit report and appraisal fees, which can cost several hundred dollars. You normally will have to wait for loan approval after all your documents have been reviewed and verified by the lender's underwriters. The time it takes to approve a loan varies from lender to lender and loan to loan, but your loan officer should be able to provide you with an estimate of how long this process will take. Much of this process is streamlined through automated underwriting and electronic credit scoring, which can expedite loan approval.

During the **underwriting** process, the lender will refer to your credit report to verify the accuracy of the information you provided. Any discrepancies can delay your loan approval, so it is important to be sure that the information you provide on your application is correct. Let your lender know if you have had past credit problems. Lenders understand that a change in your marital status, significant medical expenses or unemployment can negatively affect your credit rating. Consider including a written explanation of your situation with your loan application if there was an extenuating circumstance. If you have corrected your past credit problems, your situation may be handled quite differently than if you have a history of chronic late payments or loan defaults. If you have been through bankruptcy within the past seven years, you will have to provide full details, including a copy of relevant documents.

Within three business days of you submitting your loan application, the lender must give you two important documents: a Truth-in-Lending statement and a Good Faith Estimate of your closing costs. Sample documents are provided on pages 43–44. The Truth-in-Lending statement includes the loan's APR and provides other specific about the loan, such as the total finance charge, the schedule of payments, the total amount of all payments, late payment charges, and whether there are any prepayment penalties. The Good Faith Estimate details every fee you will likely pay as closing costs and adds up the total amount of those costs. If you need help understanding these documents after you receive them, visit a reputable housing counselor or licensed attorney.

Loan Processing

After you have completed your loan application, your loan officer turns it over to the loan processing department. It is the loan processor's responsibility to gather all of the information and documentation needed to make a loan decision. The loan processor verifies that the information you provided is correct, orders and reviews your credit report and property appraisal, **verifications** and other documents. The loan processor may contact you during this process to ask you for additional documents or explanations.

Loan Underwriting

Once the loan package is complete, the underwriter reviews all the facts about your loan — your capacity to repay the loan, your credit risk and the value of your **collateral.** The underwriter compares your information with the policies and criteria of the lender's loan program and determines whether or not to approve the loan. Once your loan is approved you will receive a written **commitment letter,** guaranteeing you the loan at specific terms for a set period of time. The commitment is a legal

document, so it is important that you understand everything in it. If you wish to accept the loan, you must sign and return a copy of the commitment letter to the lender before the specified deadline.

Loan Closing

Once your lender approves the loan, the closing agent (title company, attorney or escrow company, depending your state) will prepare the HUD-1 Settlement Statement, check the title report, prepare the mortgage documents to be recorded, and close the transaction. According to federal law, you have the right to see your HUD-1 Settlement Statement 24 hours before your closing. You just need to call the closing agent several days or more in advance to let them know that you would like to have a copy of the statement to review prior to the closing.

As you may remember from when you took out your original mortgage, you will have to sign many pieces of paper at the closing. Once you have completed the necessary paperwork, your refinance or equity loan transaction is complete. During a closing borrowers sometimes experience significant pressure to sign the mortgage documents and complete the transaction quickly. Plan on taking your time at the closing and follow the tips provided below:

- *Ask any questions you have* about your mortgage documents before you sign them.
- *Bring documents,* such as your Good Faith Estimate, Truth-in-Lending statement, and worksheets, with you to compare them with your closing documents. Make sure all numbers and terms are what you expected.
- *Read all disclosures,* even if the lender says that they are not important.
- *When in doubt, do not sign anything.* Consult a licensed attorney or other trusted source to review your documents.

Federal law gives you the right to rescind, or cancel, a refinance or home-equity transaction during the three business days following your closing. This **Right of Rescission** is designed to protect you against lenders who may have pressured you into agreeing to a loan that may put your home at risk. During this three-day period, you can share your documents with a licensed attorney or other trusted source to ensure that your loan is fair and affordable.

The Truth-in-Lending Act is aimed at promoting the informed use of consumer credit by requiring disclosures about terms and costs.

SAMPLE TRUTH-IN-LENDING DISCLOSURE STATEMENT
(THIS IS NEITHER A CONTRACT NOR A COMMITMENT TO LEND)

Applicants:
Property Address:
Application No:

Because you may be paying points and other fees, the APR disclosed is often higher than the interest rate on your loan. The APR can be compared to other loans to give you a fair method of comparing prices.

Prepared By:
Date Prepared:

The mortgage amount minus prepaid finance charges (loan origination fees, points, adjusted interest and initial mortgage insurance premium) and any required balance. It represents a net figure to allow you to accurately assess the amount of credit actually provided.

ANNUAL PERCENTAGE RATE	FINANCE CHARGE	AMOUNT FINANCED	TOTAL OF PAYMENTS
The cost of your credit as a yearly rate	The dollar amount the credit will cost you	The amount of credit provided to you or on your behalf	The amount you will have paid after making all payments as scheduled
%	$	$	$

The estimated total amount you will have paid, including principal, interest, prepaid finance charges and mortgage insurance, if you make minimum payments for the entire loan term.

☐ REQUIRED DEPOSIT: The annual percentage rate does not take into account your required deposit

PAYMENTS: Your payment schedule will be:

Number of Payments	Amount of Payments**	When Payments Are Due	Number of Payments	Amount of Payments**	When Payments Are Due	Number of Payments	Amount of Payments**	When Payments Are Due
		Monthly Beginning:			Monthly Beginning:			Monthly Beginning:

Principal, interest and mortgage insurance if applicable.

The estimated total amount of interest payments for the term of the loan, the amount of interest paid at closing, origination fee and any other charges paid to the lender.

Defines circumstances under which the remaining principal and interest amount of the loan is due and payable on demand.

☐ DEMAND FEATURE: This obligation has a demand feature.
☐ VARIABLE RATE FEATURE: This loan has a variable rate feature. A variable rate disclosure has been provided earlier.

CREDIT LIFE/CREDIT DISABILITY: Credit life insurance and credit disability insurance are not required to obtain credit, and will not be provided unless you sign and agree to pay the additional cost.

Type	Premium	Signature	
Credit Life		I want credit life insurance.	Signature:
Credit Disability		I want credit disability insurance.	Signature:
Credit Life and Disability		I want credit life and disability insurance.	Signature:

INSURANCE: The following insurance is required to obtain credit:
☐ Credit life insurance ☐ Credit disability ☐ Property insurance ☐ Flood insurance
You may obtain the insurance from anyone you want that is acceptable to **creditor**
☐ If you purchase ☐ property ☐ flood insurance from creditor you will pay $ for a one year term.

SECURITY: You are giving a security interest in:
☐ The goods or property being purchased ☐ Real property you already own

FILING FEES: $

An estimate of the cost of recording the legal documents (mortgage or deed of trust) connected with the transaction, which will be charged at closing.

LATE CHARGE: If a payment is more than days late, you will be charged % of the payment

PREPAYMENT: If you pay off early, you
☐ may ☐ will not have to pay a penalty.
☐ may ☐ will not be entitled to a refund of part of the finance charge.

Defines whether a fee will be charged and if you would be eligible for a refund if you wish to repay part or all of the loan in advance of the regular schedule. If you are not entitled to a refund, you will be charged interest for the period of time you used the money loaned to you. Your prepaid finance charges and any interest already paid are generally not refundable. If you pay off early, you should not have to pay the full amount of the finance charges shown on the disclosure.

ASSUMPTION: Someone buying your property
☐ may ☐ may, subject to condition ☐ may not assume the remainder of your loan on the original terms.

See your contract documents for any additional information about nonpayment, default, any required repayment in full before the scheduled date and prepayment refunds and penalties.

** NOTE: The Payments shown above include reserve deposits for mortgage insurance (if applicable), but exclude property taxes and insurance.

Defines whether the loan can be passed on from a seller of a home to another buyer, where the buyer "assumes" all outstanding payments.

THE UNDERSIGNED ACKNOWLEDGES RECEIVING A COMPLETED COPY OF THIS DISCLOURE.

____
(Applicant) (Date)

____
(Lender) (Date)

Lenders are required by law to provide the information on this statement in a timely manner. Your signature merely indicates that you received this information and does not obligate you or the lender in any way.

The Real Estate Settlement Procedures Act (RESPA) is designed to inform consumers when shopping for a mortgage loan by disclosing the estimated costs associated with obtaining the loan.

SAMPLE GOOD FAITH ESTIMATE

Applicants: | Application No:
Property Address: | Date Prepared:
Prepared By: | Loan Program:

The information provided below reflects estimates of the charges that you are likely to incur at the settlement of your loan. The fees listed are estimates - actual charges may be more or less. Your transaction may not involve a fee for every item listed. The numbers listed beside the estimates generally correspond to the numbered lines contained in the HUD-1 settlement statement, which you will be receiving at settlement. The HUD-1 settlement statement will show you the actual cost for items paid at settlement.

Total Loan Amount $ Interest Rate: % Term: mths

800	ITEMS PAYABLE IN CONNECTION WITH LOAN:			PFC S F POC
801	Loan Origination Fee	$		
802	Loan Discount			
803	Appraisal Fee			
804	Credit Report			
805	Lender's Inspection Fee			
808	Mortgage Broker Fee			
809	Tax Related Service Fee			
810	Processing Fee			
811	Underwriting Fee			
812	Wire Transfer Fee			
1100	TITLE CHARGES:			PFC S F POC
1101	Closing or Escrow Fee:	$		
1105	Document Preparation Fee			
1106	Notary Fees			
1107	Attorney Fees			
1108	Title Insurance:			
1200	GOVERNMENT RECORDING & TRANSFER CHARGES:			PFC S F POC
1201	Recording Fees:	$		
1202	City/County Tax/Stamps:			
1203	State Tax/Stamps:			
1300	ADDITIONAL SETTLEMENT CHARGES:			PFC S F POC
1302	Pest Inspection	$		
	Estimated Closing Costs			
900	ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE:			PFC S F POC
901	Interest for days @ $ per day	$		
902	Mortgage Insurance Premium			
903	Hazard Insurance Premium			
904				
905	VA Funding Fee			
1000	RESERVES DEPOSITED WITH LENDER:			PFC S F POC
1001	Hazard Insurance Premium months @ $ per month	$		
1002	Mortgage Ins. Premium Reserves months @ $ per month			
1003	School Tax months @ $ per month			
1004	Taxes and Assessment Reserves months @ $ per month			
1005	Flood Insurance Reserves months @ $ per month			
	Estimated Prepaid Items/Reserves			
TOTAL ESTIMATED SETTLEMENT CHARGES		$		

PFC = Prepaid Finance Charge (fees that affect the APR)

S = Seller Paid

F = FHA Allowable Fees

POC = Paid Outside of Closing

Elements of your projected loan payments (interest, taxes and insurance) that must be prepaid to establish the escrow account and the loan schedule.

TOTAL ESTIMATED FUNDS NEEDED TO CLOSE:			TOTAL ESTIMATED MONTLY PAYMENT:	
Purchase Price/Payoff (+)		New First Mortgage (-)	Principal & Interest	
Loan Amount (-)		Sub Financing (-)	Other Financing (P & I)	
Est. Closing Costs (+)		New 2nd Mtg Closing Costs (+)	Hazard Insurance	
Est. Prepaid Items/Reserves (+)			Real Estate Taxes	
Amount Paid by Seller (-)			Mortgage Insurance	
			Homeowner Assn. Dues	
			Other	
Total Est. Funds needed to close			**Total Monthly Payment**	

These estimates are provided pursuant to the Real Estate Settlement Procedures Act of 1974, as amended (RESPA). Additional information can be found in the HUD Special Information Booklet, which is to be provided to you by your mortgage broker or lender, if your application is to purchase residential real estate property and the lender will take a first lien on the property. The undersigned acknowledges receipt of the booklet "Settlement Costs," and if applicable the Consumer Handbook on ARM Mortgages.

Applicant Date | Applicant Date

SECTION 7: UNDERSTANDING HOW TO AVOID PREDATORY LENDERS

Although most reputable lenders do not want to give you a loan that you cannot afford to repay, there are some lenders that will lend you money at exorbitant interest rates or with excessive fees that will make it difficult for you to repay. These **predatory lenders** often target people with less-than-perfect credit or those mystified or overwhelmed by the financing process. They promote their loans in terms that sound too good to be true, and often they are. If you fall prey to a loan like this, you could default on your mortgage, be subject to foreclosure and ultimately lose your home. When you refinance or borrow against your home equity, it is important to work with a reputable lender to get the best loan you can afford. It is critical to know the difference between a good loan and a bad one. Mistaking one for the other could cost you your home.

Warning Signs

There are several things you should be wary of when shopping for a refinance or equity loan:

- *Unusually high interest rates* that go beyond those that protect the lender against the risks associated with borrowers with poor credit or do not reflect the quality of your credit.
- *Excessive points and fees* charged by a lender for products or services whose actual costs are far less than the price quoted to you.
- *Unnecessary products* that are financed into the cost of the loan and do not offer you anything of value.
- *Loans based solely on the equity you have in your home* without any connection to your ability to repay it.
- *Long-term abusive prepayment penalties* that make it hard for you to pay the loan off early.
- *Mandatory **arbitration** clauses* that prevent you from seeking legal remedies in court if your loan has illegal or abusive terms.
- *Steering and targeting* you toward a high-rate loan, even when you qualify for a lower rate.
- *Aggressive solicitations* for repeated refinance loans that do not offer significant benefits to you, such as cash out or a lower interest rate.

The extra charges associated with unscrupulous lenders may make it very challenging, if not impossible, for you to pay your mortgage each month. If you get behind in your payments, these lenders will often harass you until you lose your home.

Tips To Avoid Predatory Lenders

Although predatory lenders have a history of targeting their loan products to low- and moderate-income households, minorities and the elderly, anyone can be a victim. Below are some key things you should do to avoid predatory lenders:

- *Consider refinancing with your current lender.* If you have had a positive experience with the lender you borrowed from for your purchase mortgage, consider using the same lender when you refinance or borrow against your home equity. Your existing lender may even give you a slightly better rate on the loan to ensure that it keeps you as a customer. But beware if your lender or broker repeatedly asks you to refinance.
- *Seek referrals from people you trust.* Ask people you know and trust which lender they are using and whether or not they would recommend their lender. Look for a nonprofit housing organization in your area and ask them for recommendations.
- *Compare the APRs of at least three different lenders.* Look at the real estate section of your local newspaper or at Web site like www.bankrate.com to compare rates for refinance or equity loans and their true costs. This can give you a consistent point of comparison for a variety of loans and provide you with a starting point for a list of local lenders you may want to contact for a price quote. Make sure you compare loans with similar terms — the type of loan (fixed or adjustable), length of loan, etc.
- *Borrow only the amount of money that you need and can afford to repay.* Some lenders may encourage you to borrow more money than you really need or can afford. Be sure that you are clear about how much money you need and also that you have the ability to repay the loan. If you are currently having trouble paying your mortgage each month, it may not be a good idea to borrow more money. You first should try to negotiate a payment plan with your current lender that will allow you to get back on track with your existing mortgage payments.
- *Be sure that you understand exactly how much your loan will cost you.* Ask the lender the total amount you will have paid by the time you make your final loan payment. You can also find this information on the Truth-in-Lending statement that the lender must give to you within three business days of applying for a loan. Be wary of loans that have a large balloon payment at the end. These loans often have relatively low monthly payments that do not add up to enough to pay off the entire loan, so at the end of the loan term they require a big lump-sum payment. If you have difficulty making this large payment, you may end up having to refinance your loan at a time when interest rates are high. In the end, you may be in a worse situation than you were when you first got the loan. It is always important for you to look at more than just the monthly payment; look at the fees, including any prepayment penalties, the type of loan and how the rate changes if applicable, etc.
- *Be sure that the loan fees are reasonable.* Loans should not include unnecessary costs like prepaid single-premium credit or **mortgage life insurance** or credit disability insurance. These fees will increase the overall cost of your loan and result in higher payments than necessary.

- *Be sure that you understand your loan documents before you sign them.* Before you borrow any money, it is important that you understand exactly what you are getting and how much you are paying. You have the right and the responsibility to ask the lender to explain any fees, terms or conditions as many times as you need to until you understand everything. Consider contacting a local housing counselor or licensed attorney whom you trust to review the loan documents in order to ensure that you are comfortable with the loan.
- *Do not leave any spaces blank on your loan application.* Someone could fill in blank spaces later and you could end up being responsible for something you did not knowingly agree to. Look over everything you sign to make sure all your information is correct, including your income, debts and credit. Fill in any blanks with "Not Applicable," or draw a line through the space and initial it.
- *Be wary of any lender that contacts you by telephone, e-mail, mail or in person.* Try to ignore television advertisements, door-to-door salespeople or unsolicited mail from companies that are offering to refinance your loan or give you an equity loan. You should be particularly cautious of lenders who say that bad credit, low credit scores or no credit is not a problem. Remember: if it sounds too good to be true, it probably is.
- *Talk with a trusted source before you borrow against your home equity to pay off consumer debt.* Before you borrow against your home equity to pay off credit cards and other debts, contact an accredited consumer credit counseling agency. These agencies will help you determine whether borrowing against your equity is the best way to pay off your debt. These agencies can help you develop a debt consolidation plan that best meets your needs.
- *Be sure that you get the best loan that you can qualify for.* Just because a loan is not predatory does not mean that it is a good loan for you. It is critically important to shop around to ensure that you are getting the most for your money and the type of loan that meets your needs. For instance, if you need funds to pay for a new roof, make sure that the new loan will give you enough money pay for the roof. Never agree to a loan that you cannot afford to repay. Be sure that you understand the total cost of your loan, not just the monthly payment. Make sure that you are an informed shopper and that you get the help you need to make the best choice for you.
- *Remember that you can change your mind.* You have the legal right to change your mind before you sign the loan documents and up to three days after loan closing. If there is something you do not understand or feel comfortable with, do not sign your loan documents. Call a trusted housing counselor or licensed attorney for assistance before you agree to something you do not understand or are not comfortable with.

What To Do If You Think You Have Been Victimized

If you think that you have been a victim of abusive or predatory lending, it is important to let others know. This could help save your home and can help other people like you as well.

If you think you have been preyed upon:

- Contact your local office of consumer affairs or your state attorney general. You can find their numbers in the phone book (under your state in the white pages) or on the Internet.
- Report your experience to the Federal Trade Commission (FTC). The FTC can be reached toll-free at (877) FTC-HELP (382-4357).
- Contact your local legal services or legal aid organization. Its staff can review your loan documents before or after you sign them. They can provide you with guidance if you would like to file a complaint against your lender. You can find the contact information for these local agencies in the phone book or on the Internet.

Section 8: Understanding Your Responsibilities After Loan Closing

Now that you have either refinanced your mortgage or borrowed against your home equity, there are some things that you should keep in mind to ensure that you will continue to be a successful homeowner.

Importance of On-Time Mortgage Payments

When you close your loan, you are making a promise to repay your lender through a series of monthly mortgage payments. It is extremely important that you pay your mortgage on time every month. This will help you maintain a good credit rating and will enable you to avoid late fees, which can be costly and make it difficult for you to manage your money.

Tax Considerations

As you know, homeownership may offer tax advantages. Current law permits you to fully deduct the mortgage interest you pay on up to $1 million of acquisition debt (mortgages acquired to buy, build or improve on your home, including straight refinance loans and loans for home improvements) from your total taxable income. This is a key benefit that the federal government provides homeowners to reduce the costs associated with homeownership. In addition, if you have home-equity debt (mortgages acquired other than to buy, build or improve your home), you can deduct the mortgage interest paid on a principal loan balance up to $100,000. A cash-out refinance loan for any reason other than home improvement is considered to be a mixed-use mortgage because a portion of the proceeds will be used to refinance the mortgage you used to buy your home (acquisition debt) and the remaining portion (home-equity debt) will be used for other activities, such as buying a car. In that case, a part of your mortgage balance would be applied to the $1 million principal limit, and the other part to the $100,000 principal limit, when calculating how much of the mortgage interest you can deduct from your taxable income. To determine how much of your mortgage interest is deductible, you will need to figure the average balance of each category of debt for the year you are filing.

As noted previously, points paid on a home-equity or refinance loan generally must be deducted over the loan term, not in the year paid. Homeownership-related deductions may reduce the federal and state income taxes you owe. This could save you money if your itemized deductions, including mortgage interest, property taxes and other home-related expenses in a given tax year, exceed your standard deduction. Your standard deduction is a dollar amount based on your filing status that reduces the amount of income on which you are taxed. For instance, if you were married (filing jointly), your federal standard deduction for 2005 was $10,000. In order for you to have saved money from itemizing, your mortgage interest, property taxes, charitable donations and other eligible deductions would have needed to be more than $10,000. Information on standard deductions is available in Publications 501 and 936 from the Internal Revenue Service, which are downloadable from www.irs.gov. Before you file next year's taxes, you may want to consult with an accountant or tax attorney for the latest rules and regulations regarding deductions.

Importance of Home Maintenance

To ensure that your home retains its value, it is important to keep up with routine maintenance and needed repairs. The rule of thumb is that home maintenance and repairs tend to cost approximately one percent of the purchase price of your home each year. It is important that you set money aside for these costs. It can be much less expensive to make a repair early on than to wait until you have a big problem on your hands. For example, it is cheaper to patch a small hole in your roof than to replace it entirely. And it is usually cheaper in the long run to hire a contractor to make a repair before a problem gets out of hand, when you have time to shop around for the best price, than to hire one once the problem reaches a crisis level. If you are hiring outside contractors to help with your repairs, be sure that they are licensed, bonded and insured, and that you check their references carefully.

Importance of Paying Your Real Estate Taxes

In addition to making on-time monthly mortgage payments, you must pay your real estate taxes on time. As part of your loan closing, you may have set up escrow accounts to pay your homeowners insurance and property taxes when they become due. In this case, your real estate tax and insurance bills are typically sent directly to your lender. Both of those bills are paid annually or semiannually, but lenders who escrow for these bills require you to pay one-twelfth ($^{1}/_{12}$th) of the annual bill each month. The lender deposits your partial payments in an escrow account, where they accumulate until it is time to pay your tax and insurance bills. If you pay your mortgage on time, your lender is responsible for paying your taxes on time. If your lender fails to make an on-time payment, it is responsible for paying any late fees. However, it is ultimately your responsibility to make sure your taxes are paid. To make sure that your property taxes have been paid, you should watch your mail for a paid receipt, or follow up with the appropriate local government agency. If you did not set up an escrow account, then it is your responsibility to pay your real estate taxes. Failure to pay your taxes can result in a lien in the amount of your tax debt being placed on your property. Once a lien is filed, your credit rating can be affected. That would make it hard for you to secure other loans at favorable rates. If you fail to pay your tax lien, you could lose your home.

What To Do If You Are Having Trouble Making Your Mortgage Payments

If you fail to make your monthly mortgage payment, your loan will go into default. If you fall behind in your payments or default on your loan, the lender may choose to foreclosure on the mortgage. At that point, if you fail to pay the total amount due, the lender can sell your home to satisfy the debt.

If you are having trouble making your payments, contact your lender right away to see if you can re-structure the loan so you can afford it. You should also seek financial counseling from a reputable housing counselor or nonprofit credit counseling agency. For the most part, lenders do not want your loan to go into default or to enter the foreclosure process. To avoid this, the lender may consider a number of options, known as loan workouts, to help prevent foreclosure. When you call, the lender will try to find out the cause of your current financial situation to determine the foreclosure-prevention option that is best for your situation. In general, you will have more options when you communicate with your lender early. The longer you wait, the more difficult it will be to save your home.

Summary

As you learned in this manual, the decision to refinance for different terms or borrow against your home equity is a difficult one, with many considerations. Both options can be beneficial. Among other things, refinancing for different terms can lower your interest rate and monthly payment, which can free up money for other financial goals like saving for an emergency fund or reducing your credit card debt. Borrowing against your home equity may also be a way for you to meet some of your larger financial goals like making home improvements or paying for a child's education.

Since your home is probably your largest financial asset, it is important for you to manage this asset wisely. If you have decided that refinancing for different rates or borrowing against your home equity is right for you, be sure to proceed with caution. Get your finances in order and shop around for the best loan available. Once you obtain your loan, make on-time payments to protect your investment and your credit rating.

GLOSSARY

See more details about financing terminology on page 29.

80/20 MORTGAGE: A type of 100 percent financing for borrowers, often called a piggyback loan, which combines a first mortgage at 80 percent loan-to-value with a second mortgage for the remaining 20 percent.

ADJUSTABLE-RATE MORTGAGE (ARM): A loan that adjusts on a regular schedule based on a national economic index and the lender's margin.

AMORTIZATION: The process of paying off a loan with regular payments over a fixed time period.

ANNUAL PERCENTAGE RATE (APR): The cost of borrowing money expressed as a yearly rate, which includes the interest, points and other fees charged by the lender.

APPRAISAL: A professional opinion of the market value of a property.

APPRECIATION: An increase in the value of a house due to changes in market conditions, home improvement or other factors.

ARBITRATION: A dispute resolution mechanism, whereby an independent, neutral third party is appointed to hear and consider the merits of the dispute and render a final and binding decision.

ASSET: Anything an individual owns that has commercial or exchange value.

BALLOON-PAYMENT MORTGAGE: A loan with fixed monthly payments based on a 30-year schedule of payments on which the entire balance of the loan comes due at the end of a set period, usually five, seven or 10 years.

BANKRUPTCY: A legal proceeding declaring that an individual is unable to pay debts, which may release the person from repaying debts owed.

BIWEEKLY MORTGAGE: A loan with a fixed term and a schedule of monthly payments at the current interest rate, where partial payments are made every two weeks. This results in one extra payment per year, helping the borrower to pay the off the loan sooner and save money on total interest charges.

BORROWER: The person who obtains a mortgage loan.

BREAK-EVEN POINT: How long it would take for a borrower to recoup the total costs of refinancing, including closing costs, fees, points and prepayment penalties.

CAP: The maximum amount an interest rate on an adjustable-rate loan can increase or decrease in a designated period of time (adjustment cap) or over the life of the loan (lifetime cap).

CASH-OUT REFINANCE: A loan that allows a homeowner to borrow more money using the home's value as collateral by replacing the old mortgage with a new, larger one.

CLOSING: The final step in the mortgage loan process, where the borrower signs the mortgage and mortgage note and pays any closing costs.

CLOSING COSTS: Expenses incurred by obtaining a mortgage loan.

COLLATERAL: Property accepted as security for a loan.

COMBINED LOAN-TO-VALUE: The ratio of the sum of all loan balances to the value of the house.

COMMITMENT LETTER: A formal offer by a lender stating the terms under which it agrees to loan money to a borrower.

CONFORMING CONVENTIONAL LOAN: A loan made by for-profit lenders and not insured by the federal government that meets specific eligibility criteria to be sold to secondary-market investors.

CREDIT REPORT: A record of how a consumer has repaid credit in the past, used as a guide to determine a potential borrower's creditworthiness.

CREDIT REPORTING AGENCY: A company that gathers, files and sells information to **creditors** and others with a legitimate business purpose.

CREDIT SCORE: A numerical value based on the analysis of a credit report that is used by creditors to predict how likely an individual is to repay a new loan.

CREDITOR: A person or firm to whom money or its equivalent is owed.

DEBT: Money owed. Also called "liability."

DEBT-TO-INCOME RATIO: The maximum percentage of a borrower's gross monthly income that can be spent on the house payment and all other creditor debts.

DEFAULT: Failure to meet financial obligations, which may result in the lender foreclosing on the loan.

DEPRECIATION: A decrease in the value of property due to changes in market conditions, wear and tear on the property, or other factors.

DISCOUNT POINTS: Points a borrower pays in advance in order receive a lower interest rate.

DISCRETIONARY INCOME: The amount of money left over in a month after regular expenses are subtracted from take-home pay (net income).

DOCUMENT RECORDING: The process of recording certain documents following closing and making them part of the public record.

EQUITY: The difference between what a house is worth and what the owner owes, or a borrower's ownership interest in a property.

ESCROW ACCOUNT: A special account set up by the lender to collect and hold monthly payments toward annual property taxes and homeowners insurance.

FIRST MORTGAGE: A home loan that has priority over the claims of subsequent lenders for the same property in the event of default.

FIXED-RATE MORTGAGE: A loan on which the interest rate remains the same over the life of the loan.

FORECLOSURE: The legal process used to force the payment of debt secured by collateral whereby the property is sold to satisfy the debt.

FUNDING FEE: The charge paid by the borrower at closing to the VA or USDA for issuing its guarantee on a VA or USDA, Rural Development, Rural Housing Service loan.

GOOD FAITH ESTIMATE: A document that discloses anticipated settlement costs.

HOME-EQUITY LINE OF CREDIT: A specialized form of a home-equity loan, where the balance can go up or down. The borrower is approved to borrow up to a certain amount of money in large or small amounts as needed.

HOME-EQUITY LOAN: A second or junior mortgage loan that is secured by a portion of the home's value.

HOME IMPROVEMENT: Changes to a house that increase its value.

HOMEOWNERS INSURANCE: An insurance policy on a house and its contents that combines liability coverage and hazard insurance.

HUD-1 SETTLEMENT STATEMENT: A final statement listing all of the closing costs for a mortgage transaction.

INDEX: A published market index rate tied to an economic indicator that is used to calculate the interest rate of an adjustable-rate mortgage at origination and at each adjustment period.

INTEREST: The cost of borrowing money.

INTEREST-ONLY MORTGAGE: A fixed- or adjustable-rate loan that allows a borrower to pay only monthly interest payments during an initial period of time. At the end of the interest-only period, the loan becomes fully amortizing for the remainder of the loan term.

INTEREST RATE: The percentage of the loan amount charged for a loan.

INTEREST RATE LOCK-IN: A written guarantee that a buyer will receive a specified interest rate from a lender, provided that the loan closes within a set period of time.

LENDER: The entity or person who offers the mortgage loan.

LIABILITY: Money owed. Also called "debt."

LIEN: A legal hold or claim of one person on the property of another as security for a debt.

LOAN FEES: Costs associated with loan processing.

LOAN MODIFICATION: An agreement between a lender and a borrower that changes the terms of the loan.

LOAN SERVICER: The company that collects mortgage payments and manages the operational procedures related to a mortgage loan.

LOAN TERM: The amount of time a borrower has to pay off a loan.

LOAN-TO-VALUE RATIO (LTV): The ratio of the loan balance to the value of the house.

LOAN WORKOUT: A negotiated agreement between a borrower and a lender or servicer to address a mortgage in default in order to avoid foreclosure.

MARGIN: The set percentage the lender adds to the index rate to determine the interest rate of an adjustable-rate mortgage.

MORTGAGE: A security agreement between the lender and the buyer in which the property is collateral for the loan. The mortgage gives the lender the right to collect payment on the loan and to foreclose if the loan obligations are not met.

MORTGAGE INSURANCE: A policy required by conventional and FHA lenders when a borrower has a first mortgage loan with a loan-to-value above 80 percent of the appraised value of the home. This insurance protects the lender from collateral risk in case of default.

MORTGAGE LIFE INSURANCE: An optional form of life insurance that pays off a mortgage if the borrower dies.

MORTGAGE PAYMENT: The total monthly loan payment, known as principal, interest, taxes and insurance (PITI).

NET INCOME: Money earned after taxes and other payroll deductions have been withdrawn.

NONPRIME LOAN: A type of loan that relies on risk-based pricing to serve borrowers who cannot obtain credit in the prime market, where higher degrees of risk for borrowers carry higher costs for loans. Nonprime loans are often called "A– through D" credits.

ORIGINATION FEE: A fee some lenders charge for submitting, processing and evaluating a proposed mortgage loan. This fee is expressed in points.

POINT: A fee that is one percent of the loan amount.

PREDATORY LENDER: A type of lender whose lending practices combine certain products, terms, prices and practices that make it difficult for the borrower to repay the mortgage loan.

PREPAYMENT: Paying more each month than the amount of the mortgage loan payment to pay the loan off sooner and save money on interest charges.

PREPAYMENT PENALTY: A fee charged on some loans to a borrower who pays off a loan before it is due.

PRIME LOAN: A mortgage loan that is reserved for borrowers with highly rated credit histories. Prime loans are often called "A" credit.

PRINCIPAL: The outstanding balance of a loan, not including interest and other charges.

PROMISSORY NOTE: A written commitment to repay a loan at specified terms, signed at closing. Also called "note."

PROPERTY TAX: A tax charged by the local government and used to fund a variety of municipal services such as schools, police or street maintenance.

REFINANCING: The process of taking out a new mortgage and using the money to pay off the current mortgage.

REVERSE MORTGAGE: A type of home loan through which a homeowner 62 years old or older can convert the equity in the home into cash. A reverse mortgage works like a home-equity line of credit, but the homeowner does not make any payments on the loan balance as long as she or he is living in the home.

RIGHT OF RESCISSION: A right provided under federal law to borrowers who are refinancing or borrowing against their home equity that allows them three days after signing the loan documents to cancel the contract.

RISK-BASED PRICING: A system that assesses borrowing risks loan by loan to determine interest rates and fees for mortgage loans.

SECOND MORTGAGE: A home loan that has rights subordinate to the rights of the first mortgage — in other words, that in case of foreclosure is repaid after the first mortgage.

SECONDARY MARKET: Investor entities that purchase residential mortgages originated by primary lenders, thus providing lenders with money for future lending.

STREAMLINE REFINANCING: A type of refinancing that reduces the lender's level of documentation and underwriting and does not require an appraisal, credit check, income verification or qualifying ratios.

SUBORDINATION: An agreement by which a lender places its lien position behind that of another lender.

TAX DEDUCTION: An amount that is subtracted from the taxpayer's adjusted gross income to reduce the taxable income, which results in a lower amount of income tax being due.

TAX RATE: The percentage of income required to be paid in income taxes.

TITLE: A legal document establishing the right of ownership in a property.

TITLE INSURANCE: Insurance to protect the lender (lender's policy) or the buyer (owner's policy) against loss arising from disputes over ownership of a property.

TRUTH-IN-LENDING STATEMENT: A document that discloses the terms and cost of a mortgage loan, including the APR.

UNDERWRITING: The process of analyzing a borrower's finances in order to approve or deny a loan.

VERIFICATION: The process of making sure that all of a borrower's loan application information is accurate.

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