WHAT YOU SHOULD KNOW ABOUT PREDATORY LENDING

"Predatory lending" refers to a variety of lending practices that strip wealth from borrowers. High fees and excessive prepayment penalties are hallmarks of predatory loans.

Fees are costs to borrowers that are not directly reflected in interest rates. On competitive loans, fees below 1% of the loan amount are typical. On predatory loans, fees totaling more than 5% of the loan amount are common.

A prepayment penalty is a fee charged by a lender when a borrower pays off a mortgage before all the payments are due. This "early pay-off" can happen because you move or refinance your mortgage to get a lower, more affordable interest rate. While uncommon in the prime mortgage market, these penalties are included in up to 80% of subprime mortgages—those loans designed mainly for borrowers with flawed or incomplete credit histories. It's wise to ask whether a loan has a prepayment penalty, how long it will remain in effect, how much it would cost to pay off the loan early, and whether there are circumstances under which the penalty would be waived.

ADDITIONAL RESOURCES

The National Association of REALTORS®:
For information on NAR's Housing Opportunity Program, go to **www.REALTOR.org/housingopportunity**.

The Center for Responsible Lending:
For information about predatory mortgage lending practices, including "The Seven Signs of Predatory Lending," go to **www.ResponsibleLending.org**.

Fannie Mae:
Look for the section "For Home Buyers & Homeowners" at **www.FannieMae.com**.

Freddie Mac:
Look for the section on "Buying and Owning a Home" at **www.FreddieMac.com**.

Ginnie Mae:
For a simple calculator to help homebuyers estimate how much they can afford to spend, read "How Much Home Can You Afford?" at **www.GinnieMae.gov**.

HUD Housing Counselors:
For a list of counseling agencies, by state, approved by the Department of Housing and Urban Development (HUD), go to **www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm**.

"Looking for the Best Mortgage" is a brochure on how to shop, compare, and negotiate the best deal on a home loan. The brochure is a joint effort of 11 federal agencies, including the Federal Trade Commission (FTC), the Federal Reserve Board, HUD, and the Department of Justice. **www.federalreserve.gov/pubs/mortgage/mortb_1.htm**.

National Credit-Reporting Agencies:
- Equifax 800.685.1111 **www.equifax.com**.
- Experian 888.397.3742 **www.experian.com**.
- TransUnion 800.916.8800 **www.transunion.com**.

Go to **www.annualcreditreport.com** to ask for a free copy of your credit report, once a year, or call 877.322.8228. See, also, **www.FTC.gov**.

- 15- AND 30-YEAR FIXED-RATE MORTGAGES
- ADJUSTABLE-RATE MORTGAGES
- REFINANCE LOANS
- SECOND MORTGAGES
- HOME EQUITY LINES OF CREDIT

The National Association of REALTORS®, *"The Voice for Real Estate," is America's largest trade association, representing more than 1 million members involved in all aspects of the residential and commercial real estate industries. For more information, please visit www.REALTOR.org.*

The Center for Responsible Lending *is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions. Please visit our website at www.ResponsibleLending.org.*

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National Association of REALTORS®
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Shopping for a Mortgage?

DO YOUR HOMEWORK FIRST

Traditional Mortgages: Understanding Your Options

NATIONAL ASSOCIATION OF REALTORS®
The Voice for Real Estate®
REALTOR®

CENTER FOR RESPONSIBLE LENDING

UNDERSTANDING TRADITIONAL MORTGAGES

When shopping for a mortgage, consumers have more choices than ever before. Many lenders now offer specialty mortgages that help make homeownership more affordable but have risks that consumers should fully consider (see our brochure on specialty mortgages). But for most consumers, the traditional fixed-rate mortgage and adjustable-rate mortgage (ARM) continue to be excellent options. However, even these traditional financing options require a number of important decisions. Should you get a 15- or 30-year loan? Should you get a fixed-rate mortgage to lock in today's interest rates for the term of the loan—or take an adjustable-rate loan with a lower current rate and payment, but with the risk of rate and payment increases in the years ahead?

You can also tap the equity in your home by refinancing your existing mortgage, taking out a second mortgage, or obtaining a home equity line of credit. This brochure helps you consider these options as well.

We hope this brochure will help you understand traditional mortgages and make the choice that is best for you.

Fixed-Rate Mortgages: With a fixed-rate mortgage, you are guaranteed the same interest rate over the life of the loan. Your monthly payments never change, and the loan is paid off completely over the term you select.

The key choice involves how long you have to pay back the loan. The most common options are 15- and 30-year loans, with the 30-year being the most popular. As this chart illustrates, a shorter-term loan comes with both a lower interest rate and higher monthly payments (so that you pay the loan back faster). Rates, and the differences between rates for 15- and 30-year loans, change daily.

	15-Year	30-Year
Interest rate	5.5%	6%
Amount financed	$200,000	$200,000
Monthly payment	$1,634	$1,199
Loan balance after 5 years	$150,578	$186,109
Loan balance after 10 years	$85,553	$167,371

Adjustable-Rate Mortgages: The initial interest rate on an adjustable-rate mortgage (ARM) is generally lower than that for a fixed-rate loan. However, with an ARM, the interest rate may increase or decrease in the future, and the size of your payments will go up or down along with the rate.

Most ARMs are "hybrids," meaning that the interest rate is "fixed" for a certain number of years—after which the rate begins to "float." The most common ARMs fix the initial rate for three, five, or seven years. ARMs are probably most appropriate for people who have sufficient financial resources to handle potential payment increases or know that they plan to sell their home around the time the loan's interest rate is set to change.

Important Features of Adjustable-Rate Loans: Before agreeing to an ARM, you should ask the following questions:

- How long does the initial interest rate apply?
- How frequently can the interest rate change?
- How is the adjusted interest rate determined? (Generally, a specified amount—the "margin"—is added to a current published rate—the "index.")
- How high can the interest rate go?
- Does the loan set a minimum interest rate?
- Are there any limits on how much the interest rate can change each year?
- Do the monthly payments still pay off the loan even if interest rates increase? (With some loans, the amount you still owe—your "loan balance"—can increase rather than decrease each month. This is called negative amortization.)
- What is the maximum monthly payment that you could be required to pay?

Potential Pitfalls of ARMs: Even small changes in your interest rate can increase your monthly payment significantly, resulting in "payment shock." Even a change of 1% or 2% in interest rates can result in a very big jump in your monthly mortgage payment. For example, if the interest rate on your mortgage changes from 4% to 6%, your monthly payment could rise by as much as 50% (from $1,000 to $1,500).

ARMs can be complicated, and many specialty ARMs (with risky terms appropriate only for a small group of borrowers) are now being marketed widely. Be sure to avoid loans with terms that you don't understand. Get a copy of our brochure on "Specialty Mortgages: What Are the Risks and Advantages?" to learn more about these ARMs.

UNDERSTANDING HOME EQUITY

People who have paid down their mortgage or seen their home's value rise have equity in their home. Equity is the difference between the home's value and what you owe the mortgage lender. One benefit of homeownership is the ability to build equity. Homeowners draw on equity for emergencies and for retirement income. Equity also allows you to pass wealth (the home or the money made by selling that home) from one generation to the next.

Refinance Loans: In recent years, many people have refinanced their home loans to take advantage of low interest rates. Some have also refinanced in order to obtain cash. In a refinance, you pay off your mortgage with a new loan. In a "cash-out refinance," you increase the size of your debt in order to get cash at the closing table that you can use for other purposes.

In any refinance, it's important to ask about the fees you will pay. Sometimes, even substantial fees are easily hidden, as lenders may roll the fees into the loan balance. Of course, increasing the loan balance *decreases* your home equity.

BORROWING AGAINST YOUR EQUITY

Many people borrow against their equity. Two options for doing this are a traditional second mortgage and a home equity line of credit.

With both methods, you use your house as collateral—which means that you risk losing your home if you can't repay the loan according to its terms. The lender decides how much money to make available by considering, in part, how much of the mortgage debt you still owe.

Traditional Second Mortgage Loans: A second mortgage provides a predetermined amount of money that the homeowner is obligated to repay over a fixed period. Second mortgages generally come with fixed interest rates.

Home Equity Lines of Credit: A home equity line of credit (HELOC) is a form of revolving credit. Generally, you can borrow up to a certain amount (the "credit limit") over a predetermined period of time (the "draw period").

The repayment terms of HELOCs vary. For example, many HELOCs are structured so that monthly payments cover only interest for the first ten years.

A HELOC generally carries a variable rate. If you consider a HELOC, you should ask the same questions about how this rate is set (and may change over time) that you would ask when considering any other adjustable-rate mortgage.

If you sell your home, you will have to pay off or refinance your HELOC.

HELPFUL STEPS TO TAKE BEFORE BUYING A HOME

- **Check your credit status.** You have the right to receive a free credit report once a year from each of the three major credit bureaus—Equifax, Experian, and TransUnion. For completeness, it is best to review the report from each one of them. Contact information is included under "Additional Resources."
- **Work with your REALTOR® and lender to determine how much you can afford to pay for a home.**
- **Ask your lender for your credit score.** This score, which is calculated based on your credit history and other factors, determines how lenders view your credit-worthiness and the loan terms they offer. Scoring rules vary widely, but generally a score of 650 or higher means that you qualify for the most favorable loan terms.
- **Shop around.** Different lenders charge different rates and fees and have different options. Be sure to compare to get the best deal.
- **Be sure you understand the risks of your mortgage and know whether you can handle possible payment increases.**