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Building Strong Families Instructor

Upcoming Events

MCHE Council

September 20, 2005
10:00 am
ELC

October 18, 2005
10:00 am
ELC

MCHE Rally Day

October 18, 2005
6:00 pm
4-H Activity Center
Monroe County Fairgrounds

Join MCHE and kick off the new year with this fall gathering. MCHE Groups will receive their yearbooks and membership materials. Members will also be recognized for their years of service to the organization. Jennie Huths will present a program on the history of aprons.

Bring a dish to pass and your own table service. Hot and cold beverages will be provided.

Mortgages: More Choices, New Risks for Borrowers

Not that long ago your mortgage choices were relatively simple. Did you want a fixed-rate loan or an adjustable-rate mortgage (ARM)? Would you prefer a 15- or 30-year repayment period? Now, many new loan products are being widely offered that could benefit some people but be huge mistakes for others.

If you're likely to have increasing income or if you are likely to move in a few years, an adjustable-rate mortgage may be appropriate because you should be able to afford the payments if interest rates rise. But if your income is steady and you plan to stay in the house for the foreseeable future, you'll probably benefit from the security of a fixed-rate mortgage. A 30-year, fixed-rate mortgage will have lower monthly payments than a 15-year mortgage but will cost you more in the long-term. You need to decide which repayment period best suits your needs.

Once you're ready to shop for a loan, read more advice in the brochure *Looking for the Best Mortgage: Shop, Compare, Negotiate,* at www.fdic.gov/consumers/ looking/index.html.

Among the key tips in the brochure: Contact several lenders to find a selection of loan products and terms that best suit your needs. Don't just ask about the interest rate. Also inquire about loan origination fees (for processing the loan), insurance and other costs, which can be substantial. If you apply for a loan, the Real Estate Settlement Procedures Act entitles you to a "good faith estimate" of closing costs at the time you apply or within three days.

What about those new mortgage products we said may carry special risks for some borrowers?

Interest-only mortgages

Instead of paying back part of the principal (the loan amount) each month plus interest charges — the most common way mortgages are repaid — these loans require the borrower to *pay only the interest for the first five or 10 years.* After that, the borrower must either pay the loan off entirely or start paying both principal and interest monthly for the remaining period, perhaps 20 to 25 years.

Interest-only loans have been growing in popularity, especially in the "hot" housing markets, because they enable consumers to "buy up" by paying only the interest portion of the loan in the early years. But the potential risks are significant, especially if the interest rate on the loan goes up and the required payments of both principal and interest are well beyond the consumer's ability to pay each month.

"Remember, after the interest-only period ends, the monthly payment will be substantially higher than if you had used a traditional 30-year mortgage loan because the principal is being repaid over only 20 or 25 years," said Donna Gambrell, a Deputy Director of the FDIC's Division of Supervision and Consumer Protection.

Also important: What if the house hasn't appreciated in value, or even worse, has lost value when you decide to sell? "You may owe more on the loan than the house is worth, and that means you may be unable to repay the loan from the proceeds of your sale," said Gambrell. "In a worst-case scenario, if you can't sell the house and can't afford the loan payments, you could lose your home and still owe the lender a portion of the loan."

In general, an interest-only loan may be appropriate for someone new to a profession and whose initial income is somewhat low but is likely to rise quickly in the future. The loans generally are not suitable for a home owner who plans to live in the house beyond the interest-only period (more than five years) and doesn't expect increases in income to rise rapidly enough to cover the higher monthly payments.

Option ARMs

Also called "flex" ARMs, these loans let the borrower decide how much to pay from one month to the next based on a few choices. The options range from making a full monthly payment (what you'd normally pay in principal and interest with a traditional mortgage) to a "minimum" payment that doesn't cover the interest due but the shortfall is added to your loan balance. That means if you're strapped for cash you can send in a low payment and not be in default on your loan.

Option ARMs may be beneficial for people who earn a good annual salary but their monthly income fluctuates — perhaps they rely heavily on commission checks or sizeable year-end bonuses. But if they defer too much interest their total costs can go way up because they'll be paying interest on a higher loan amount, and will likely be doing that for many years. "It's similar to only paying the minimum due on your credit card," explained Gambrell. "It may seem like you're getting a big break from the lender but really you're paying a heavy long-term cost for some short-term flexibility."

As with interest-only loans, if you end up deferring a substantial amount you may owe more on the loan than the value of your home. And if you sell during a time of declining values, the sales price may not cover the loan balance.

Mortgages with no downpayment

By combining two or even three mortgages — for example, a traditional mortgage for 80 percent of the house value with two home equity loans for the remainder of the value — you may be able to purchase a home with no money down.

For some people this could be appropriate — perhaps you're expecting the house to increase in value because you plan to renovate it or you don't have any savings built up but you expect your income to increase substantially. But borrowing 100 percent of the value of the home carries risks similar to those for option ARMs, such as what happens if you can't afford the monthly payments and home values drop.

"By mortgaging the entire value of your home, the risk of losing your home increases substantially, and there's no margin for error," said Mira Marshall, a Senior Policy Analyst on consumer protection issues at the FDIC.

Mortgages with little or no documentation

These loans don't involve the usual amount of paperwork required to document the applicant's income, assets, debts and credit history. Applying for one of these loans may save you some time. You also may find these loans attractive if you have an irregular employment history or you are self-employed. The trade-off is that you'll probably be required to make a larger downpayment and/or pay a higher interest rate.

"If you can document your financial situation, it should be worth your while to provide it to the lender," added Marshall. "As with the other types of nontraditional loan products, it's important not to let the short-term ease of the transaction distract you from the long-term additional cost."

A 40-year, fixed-rate mortgage

Extending the repayment term results in a smaller monthly payment and another way to put a more expensive home within reach, but having a much smaller amount going to pay off your loan each month can dramatically increase the total interest costs. However, the security of a fixed rate may make that long-term cost worthwhile, depending on your personal situation.

This is only an introduction to shopping for a mortgage. Be sure you consult with your tax and financial advisors, and that you research as much as you can before applying for a loan.

Source: FDIC Consumer News