Chapter 9: Select the Right Mortgage and a Good Lender

When you apply for a mortgage, you need to be prepared to answer a slew of questions about your financial circumstances and credit history. As you learned in the first few chapters of this book, you'll get the best rates and terms from a lender if you have high FICO scores and a solid track record as a saver. But credit and cash won't be the only questions you encounter from lenders. They may also ask you what type of mortgage you're interested in, whether or not you want to make interest-only payments, and how long you plan to occupy the house. Knowing the answers to these questions – as well as having a basic working knowledge of how mortgages work – can help you select the right mortgage, and the right lender.

The ABCs of How Mortgages Work

People often talk about "getting" a mortgage from a bank or lending institution. But the truth of the matter is that you don't technically "get" a mortgage – you actually "give" or "pledge" a mortgage to a lender.

When you buy a home, you sign a ton of documents. Perhaps the two most important documents are the "note" and the "mortgage." The note is simply the "IOU" you sign, attesting to the fact that you owe a debt to the lender and that you are making a promise to repay that loan. A "note" is also sometimes called a "bond." The mortgage is the legal document that secures the note. Therefore, when a bank loans you money, you "give" or "pledge" to the bank that mortgage, and the bank "takes back" the mortgage (i.e. this signed legal document) as a legal claim in the event you default on the terms of the note or the mortgage. In some states, a deed of trust is used instead of a mortgage. Both a mortgage and a deed of trust are legal instruments that create a lien against the property. Once you sign a deed of trust, you receive title to a home but you convey that title to a third-party, a trustee, until your loan is paid in full. Regardless of whether your state uses mortgages or deeds of trust, both documents spell out how your loan should be repaid, and what happens if you don't pay as agreed. In a worse-case scenario, you could be foreclosed upon for failing to honor the terms of your note, mortgage or deed of trust.

Home loans are typically "amortized" over a 30-year period. This means you have a set payment schedule to pay off a part of the principal amount of the loan as well as part of the interest on the loan. In the beginning of the loan, most of your payment pays off interest, but the longer you keep the loan, a greater portion of your payment starts to pay down your principal balance. While most mortgages are offered at 30-year terms, some loans can be as short as 10 years, and others can run as long as 50 years.

Additionally, although most of us think about paying “down” a mortgage, there are some types of home loans that you can get where your balance actually increases over time. Can you imagine that? You buy a house for $400,000 and five years later you wind up owing $450,000 on the house. How is this possible? It can happen if you get a loan with “negative amortization.” Unfortunately, 12% of all loan originated in 2006 featured negative amortization. I don’t think these loans are good for any homeowners – least of all first-time homebuyers. So stay away from so-called “neg-am” loans.

What other kinds of loans spell trouble? To answer that question, you must first understand that a huge array of loan products currently exist in the mortgage arena. Some of them can get terribly complicated. Fortunately, despite all the hundreds of variations of home loans in today’s marketplace, all mortgages really boil down to two types: fixed-rate mortgages and adjustable rate mortgages, also known as ARMs.

Pros and Cons of Fixed-Rate Mortgages

Fixed-Rate mortgages are the “plain vanilla” loans of the home lending universe. But in many regions of the country, under a variety of market conditions, and for the majority of homebuyers, fixed-rate loans are the most attractive loans you can get. By attractive, I really mean safe and secure.

When you take out a fixed-rate mortgage, your loan has a set interest rate that doesn’t change, so you know exactly what your payment will be month after month, year after year. The payment you make in year one of the loan will be the same dollar amount you make in year seven, 15, 23 or year 30 of the loan – provided you keep the house and don’t sell or refinance it. The big advantage, therefore, to having a fixed-rate loan is that you are permanently locked into a mortgage that is predictable – eliminating the risk of any financial surprises later on, even if interest rates go up.

On the flip side, if interest rates go down, then your fixed-rate mortgage may not look so attractive. Assume you are paying 7% on a mortgage and interest rates drop to 6%. All of a sudden, your 7% loan doesn’t seem like such a great deal, right? To get a lower rate, you’d have to refinance your loan – a process that will involve additional fees and closing costs – because a “refi” entails paying off your existing loan and replacing it with a whole new loan.

Adjustable Rate Mortgages: Are They Right For You?

Unlike their fixed-rate cousins, adjustable rate mortgages – as their name implies – feature variable interest rates that change or "reset" over time, resulting in a mortgage payment that also fluctuates. With a 30-year adjustable rate mortgage, the interest rate you pay on a home loan could increase or decrease every year or even as often as every month, based on current interest rates. Lenders have gotten especially creative with ARMs in recent years. Banks know that many consumers favor fixed-rate mortgages for their predictability. Therefore, many popular ARM products try to mimic the stability afforded by fixed-rate mortgages. With these so-called "hybrid" ARMs, your payment could be fixed for two or three years, then move to an annually adjusted interest rate. This is the case with many 2/28 and 3/27 ARMS, which have become widespread in many markets. These loans have interest rates that are fixed for the first two or three years, then change annually for the rest of the 30-year loan term.

Consumers typically choose adjustable rate mortgages for two reasons: flexibility and affordability. Some ARMS feature "payment option" plans, which allow you to decide how much of the principal, if any, you pay on your mortgage each month. If your income is erratic, or if you find yourself in a financial pinch down the road, this can be an attractive feature. However, loans with payment option plans are also loans with negative amortizations, so if you're not careful, you could wind up not paying enough money on your home loan to knock down the principal and build equity in the home.

The second (and primary) reason people pick ARMS is to be able to afford more house than they could get with a fixed-rate mortgage. Frequently, with an adjustable rate mortgage you can get a lower-interest rate loan – initially at least – than you can get with a fixed-rate mortgage. Let's say your budget will allow you to have a mortgage with a maximum monthly payment of $2,400 a month. Now assume you find a house that required a $350,000 mortgage. If you take out a 7% fixed-rate loan over 30 years, your monthly payment (for principal and interest) would be $2,329. The only problem is: you're not completely in love with this particular house. Your dream home – the one you really want – is actually $100,000 more. With the traditional 30-year fixed rate mortgage, you couldn't afford it because with a $450,000 loan, your monthly mortgage would be $2,994 – nearly $600 above your financial comfort zone. But what if you could get a lower monthly payment simply by selecting a 5/1 ARM, an adjustable rate mortgage that features a low "teaser" rate of just 5.75% for the first five years, and which converts, in the sixth year of the loan, to prevailing interest rates. Under this scenario, your initial mortgage payments would be $2,628.

Many homebuyers facing this dilemma follow their hearts – not their wallets – and choose the higher priced house. Sure, it's $228 above their pre-set monthly limit, but because the ARM features such a low interest rate to start with, buyers allow themselves to "stretch" their budget and select a more expensive house. For those with steadily rising incomes, an ARM can be a reasonable option. However, it's risky to bet that "it will work out somehow," and take a mortgage loan without knowing precisely how you'll pay it. It's equally risky to get an ARM thinking "I can always refinance later" or "The house will definitely appreciate in value." Neither scenario is guaranteed. And what happens if you lose your job or the real estate market suffers a downturn? Refinancing or selling won't be so easy.

What Flavor Is Your Mortgage: Plain Vanilla or Exotic?

I've already told you that 30-year fixed rate home loans are the "plain vanilla" mortgages of the industry. These are classic loans – the one your grandparents likely had if they were homeowners. By contrast, adjustable rate mortgages come in many flavors, including many quite exotic ones. Here's a brief description of five commonly offered exotic mortgage products:

- **deferred interest or negative amortization loans**, which let you pay less than what you'd normally owe in principal and interest, potentially resulting in your loan balance increasing instead of decreasing.

- **hybrid ARMs**, which feature a below-market fixed interest rate for a set period of time, after which your loan resets to a higher interest rate.

- **balloon loans**, which feature low fixed payments for a set period of time, and then a lump sum payment due in the future to pay off the majority of the loan.

- **Interest-only loans,** which provide you with very low monthly payments to start with, because you only pay the interest due on the loan. After a grace period, your payments rise dramatically since you must also begin repaying the principal balance.

- **option ARMs**, which let you pick a payment each month that's comfortable for you; the options typically are:

- a “minimum payment” choice, which is less than the interest due on the loan, leading to negative amortization
- an interest-only payment
- a normal payment of principal and interest, which fully amortizes or pays of your loan in 30 years; and
- a fully amortizing 15-year payment

Interest Only Loans: A Buyer’s Dream or Nightmare?

Between 2002 and 2006, adjustable rate mortgages became enormously popular in the U.S – particularly “interest only” loans. It’s not surprising that the explosion in ARMs during this five-year period coincided with the rapid run-up in home prices all across the country. In 2006, nearly one-third of all new mortgages were interest-only or payment option loans. These are loans that allow you to pay only the interest due on the loan for a period of time usually 5 or 10 years; later, you make principal payments as well so that your loan is fully amortized and paid off in 30 years. When people select interest-only loans, it’s usually because they’re trying to have the smallest monthly payment possible.

You may think that it’s a sweet deal to be able to qualify for a bigger loan and get a pricier house using an interest-only loan. Unfortunately, for many people, interest only loans are mortgage products that turn out to be less of a dream loan and more of a nightmare. This normally occurs when some anticipates having a higher income down the road, but those expectations don’t pan out. Then their payments jump because the principal balance must also be repaid. For cash-strapped borrowers who are unable to refinance or sell, an interest-only mortgage that has re-set can become financially crippling.

In general, I don’t recommend interest-only mortgages for first-time buyers. When new homebuyers use these loans, it’s usually a dead giveaway that they’re over-extending themselves, trying to buy too much house than they can realistically afford. Interest-only mortgages do have a place in the market, though. Savvy real estate investors use them all the time. Indeed, they can also be useful to you later, if you buy investment property and you want to start with lower monthly payments which rental tenants will eventually cover. Additionally, if you trade up to a different or bigger house down the road, sometimes an interest-only loan makes sense while you have your first house on the market – waiting to sell it. The purpose of an interest-only loan in this case is to reduce your out-of pocket costs in the event you have to temporarily carry two mortgages.

Some Thoughts About Sub-Prime Mortgages

In 2007, you couldn't watch television, listen to the radio or read the newspaper without hearing about the meltdown in the sub-prime mortgage market. After a steady stream of mortgage delinquencies and defaults by homeowners with sub-prime loans – many of them ARMs that had reset – the entire mortgage business experienced a major shakeout. Hundreds of thousands of homes went into foreclosure when borrowers experienced payment shock and could no longer afford their mortgages. Hundreds of lenders went out of business, resulting in scores of job losses in the mortgage, real estate and home-building industry. And after Wall Street took a beating because of what was happening in the sub-prime mortgage market, the Federal Reserve Bank stepped in to calm the markets by cutting interest rates and making loans to ailing banks. As of this writing, the reverberations from the sub-prime mess are still being felt – among lenders, homeowners, would-be home buyers and practically every one else tied to the real estate business.

So what exactly happened? And exactly what is a "sub-prime" loan? Sub-prime mortgage loans are made to people with less than perfect credit histories. As a result, they are more costly mortgages because lenders price in a higher risk of default for customers with credit blemishes. In 2006, sub-prime loans represented 20% of the $7 trillion mortgage market. Yet, in the first quarter of 2007, sub-prime loans accounted for 54% of all foreclosures. By the summer of 2007, the rising delinquency and foreclosure rate in the sub-prime market spread to the entire mortgage arena, causing lenders of all kinds to tighten their credit standards – even to customers with perfect credit.

Despite all the terrible press they've received, sub-prime loans are not inherently "bad" loans. In fact, the existence of responsible and fair sub-prime lending has given millions of people access to homeownership by expanding credit criteria and creating more flexible mortgage guidelines and products for buyers who don't have stellar credit records. The problems that occurred in the sub-prime market, however, resulted from a lethal combination of lenders offering too many "exotic" mortgages, falling home prices, higher interest rates, buyers stretching to purchase more house than they could truly afford and not understanding the types of mortgages they were getting, lax federal oversight of the mortgage business, and finally, predatory tactics by some lenders.

Not all sub-prime mortgages are predatory loans – which are loans characterized by unreasonably high interest rates, abusive pre-payment penalties, or excessive loan fees, including enormous commissions for mortgage brokers. Unfortunately, predatory lenders operating in the sub-prime arena have taken advantage of buyers in recent years – socking homebuyers with much higher interest rates and more punitive loan terms than warranted. The net result is that while sub-prime loans now account for about one out of every six mortgages, they result in more than two-thirds of all foreclosures.

For these reasons, I must caution you that if you do take out a sub-prime loan, it's imperative that you truly know what you're getting, and that you also deal with a reputable lender who won't financially exploit the fact that you lack A-1 credit.

Choosing The Optimal Loan For Your Situation

You should be as careful about your selection of a mortgage as you are about choosing the home you will purchase. A mortgage is a major financial commitment, so it's incumbent upon you to take the necessary time and effort to pick the optimal loan for your situation. Your selection of the "right" mortgage will also be driven by future considerations. It's not enough to think about your financial picture and your circumstances today. Where do you plan to be five or 10 years from now? Is the home you're buying one that you plan to stay in for just a couple of years, or do you intend to occupy the home for many years to come? The answer to these questions can also help you choose the best loan product.

A key part of your decision-making should involve your financial temperament. Are you an economically conservative person – one who would sleep better at night knowing that your mortgage payment is fixed and that no matter where interest rates go, you have an established house payment that won't fluctuate? If so, a 30-year fixed mortgage would obviously suit you best. On the other hand, if you are a more risk tolerant person – the type of individual who doesn't mind a bit of financial uncertainty regarding interest rates if it meant you could reap some possible savings – and you wouldn't mind hedging your bets in the hopes of getting a better deal down the road, an ARM is worth exploring.

Whatever type of loan you select, keep in mind that the typical borrower keeps a mortgage for about seven years before paying that loan off. More often than not, people will refinance their loans, or they sell their properties, and pay off the loans when because they're moving on to a different place. Think about your own personal life, professional career and future goals. Are you likely to stay put for a while, or could a move – for a job relocation, family or other reasons – be in your future? In my opinion, if you are reasonably confident that you'll be in a home for at least seven years, then getting a fixed-rate mortgage is often a no-brainer. But if you're certain that you'll be in the house for fewer than seven years, perhaps because you'll marry or you plan to have a baby, in this case you might consider an ARM, namely one that re-sets after you're likely to have sold the house and moved.

Private Mortgage Insurance Vs. "Piggyback" Loans

With conventional mortgage loans, any time you put down less than a 20% down payment, you must also pay for something called "Private Mortgage Insurance." This is insurance that protects your lender against you defaulting on your mortgage loan. Many buyers hate the thought of paying for insurance that they feel benefits only the lender. In reality, Private Mortgage Insurance, commonly called PMI, does benefit borrowers. The existence of PMI has expanded homeownership in America because this insurance coverage makes lenders far more willing to issue low down payment loans – and even no-money-down loans – because lenders have a guarantee that should you not meet your mortgage obligations, PMI will help offset the lenders' losses. PMI also helps you get into a home faster, without having to save up 20% for a house down payment.

Over the past decade, many lenders pushed "piggyback" loans as a way for borrowers to avoid PMI. Here's how it worked. A homebuyer seeking a no-money-down loan could get 100% financing for a mortgage by taking out two separate loans. The first loan featured an 80% loan to value ratio. The second loan – the "piggy back" loan – would be done at 20% of the purchase price of the home. And since the primary loan fell within lender guidelines of having an 80% loan-to-value ratio, the borrower could bypass PMI. Let's say you did have a 5% down payment. In this case, lenders would suggest that you do what's called an 80-15-5 loan: the first mortgage for 80%, a 15% piggyback loan, along with your 5% down payment. With a 10% down payment, you'd do an 80-10-10 loan to avoid PMI. Needless to say, borrowers had to always do the math to see whether or not it was actually cheaper to take out a second loan versus paying mortgage insurance. In many cases, making monthly payments on a second loan was less expensive than paying a monthly PMI premium. But in other cases it was not.

Nowadays, PMI is a lot more attractive as an alternative to piggyback loans. One big reason for the appeal of PMI is that it is now tax deductible thanks to a new federal law passed by Congress, which went into in effect in 2007. In previous years, borrowers didn't get a tax break for paying PMI, as they did with second mortgage loans. Since PMI and piggyback loans are on equal footing now in terms of tax deductibility, it's more important than ever that you compare your options and see which results in the best net financial result.

Under the new law, if your adjusted gross income is less than $100,000, you are entitled to deduct the full amount of your mortgage insurance premiums on your federal tax returns. Deductions are phased out in 10% increments if your adjusted gross income falls between $100,000 and $109,000.

Another reason PMI is attractive, when compared to a piggyback loan, is that PMI can be canceled after just two years if the value of your house has risen and you have at least 20% equity in the home. Additionally, mortgage insurance premiums are fixed payments, and remain unchanged regardless of what interest rates do. Many piggyback loans carry variable interest rates and fluctuate with changing interest rates.

Some of the largest PMI companies in the nation include Mortgage Guarantee Insurance Corp., General Electric Mortgage Insurance Co., and PMI Mortgage Insurance Company. Janet Parker, Senior Vice President of National Underwriting Operations for PMI Mortgage Insurance Co., says: “We have a tag line that we say: ‘MI is simple, safe and smart.’”

“It’s actually a very simple process to get mortgage insurance if you have less than a 20% down payment,” Parker adds. “The MI can be folded into your loan or you can pay a separate monthly payment every month. It’s cancelable. And most big servicers have a protocol by which they cancel PMI automatically once the loan to value ratio drops below 80%.”

Advice for Selecting a Reputable Lender

When you approach a lender, you should already have in mind what type of mortgage you want: a fixed-rate loan or an adjustable rate product. You should also know whether or not you’ll need to pay PMI. Finding the right lender for a home loan can be challenging because you there are three ways to get a loan: through brokers, mortgage bankers and direct lenders. They are all regulated differently and each group of professionals makes different disclosures to you about the mortgages they offer.

The Federal Trade Commission suggests that you avoid any lender who:

- Advises you to falsify information on your loan application
- Pressures you to take out a loan that is more money than you need or can afford
- Rushes you to sign paperwork you haven’t read, telling you that the fine print isn’t important
- Pulls a bait-and-switch on you, by promises you a favorable set of loan terms when you apply but then unfairly changing the terms at the last minute
- Requests that you sign blank forms, stating that they’ll fill them in later

- Refuses to give you copies of documents you've signed

You should also stay away from lenders who:

- **Push single premium credit insurance**

Consumers Union and ACORN Housing Corporation, which helps low-to-moderate first time buyers, have both called credit insurance "the nation's worst insurance ripoff," partly because this insurance is very over-priced compared to term life insurance. For example, a typical five-year credit life policy costs over $5,000 more than a comparable a term life insurance policy of 10 years, according to ACORN. What is also especially onerous about single premium credit insurance is that, when you take out this insurance in connection with a mortgage, the entire cost of the insurance policy is charged up front and added to your loan amount. The loan officer or broker gets as much as 40% of your premium, plus credit insurance doesn't even offer protection for the entire duration of your loan. Instead, it typically only covers the first three to five years of a 30-year mortgage.

- **Ask information that violates the law**

The Equal Credit Opportunity Act (ECOA) dictates what information a lender can request, and what information is none of their business. The law bans credit discrimination on the basis of your sex, race, religion, age, national origin, marital status, or receipt of public assistance income. Therefore, lenders can't ask you about these areas if they intend to discriminate against you. There are some exceptions to this rule. A lender can request your age to make sure you are legally of age to sign for a loan. A lender can inquire about your marital status to determine income or if you say you will have a co-signer on the loan. Even if you are married, if you choose to take out a mortgage exclusively in your own name, the lender doesn't have the right to ask about your spouse's personal finances.

Can You Benefit From Using a Mortgage Broker?

Mortgage brokers are essentially middlemen in the home loan business. When you use a broker, he or she will tap into his network of lenders and try to find a loan that suits your needs. In the best-case scenario, a broker will work to get you the best rates and loan terms for which you qualify. That's the ideal. In practice, however, it doesn't always work that way.

Critics say that abuses in the lending industry are more prevalent among brokers than elsewhere in the mortgage business. Observers contend fraud and abuse are more likely because of the looser regulations brokers face. The Conference of State Bank Supervisors reports that 32 states don't require people to pass a test before obtaining a mortgage-broker license. Moreover, nine states don't require criminal background checks on license applicants. As a result, the Conference of State Bank Supervisors is creating a national database to let consumers and regulators verify whether brokers are licensed or learn if they've had any regulatory enforcement actions. Senator Chuck Schumer of New York in 2007 introduced legislation that would establish a fiduciary duty for brokers and others who arrange home mortgage loans, mandating that they look after their customers' best interests. Some people say that there needs to be better disclosures to consumers about how brokers are compensated.

Because brokers find customers for lenders and handle the initial loan processing, brokers can be paid for their efforts by both the lender, and you, the buyer.

In many cases, brokers can get you better interest rates because they receive "wholesale" interest rates from direct lenders, such as Bank of America, Chase, or Washington Mutual. Let's say you went into a major bank for a home loan. They might quote you a rate of 7.5%. But they might quote the broker – who is giving them 25 loans a month – a rate of 6.5%. The broker can then pass on that lower 6.5% rate to you. Frequently, however, brokers don't always do exactly that. Sometimes they might quote you a rate of 7% -- still better than what you could get on your own. Then they pocket the other .5% as profit. This is called a YSP, or yield spread premium, and it's one of the ways that mortgage brokers get paid in the industry.

When you apply for a mortgage loan, by law a lender is required to give you a Good Faith Estimate (GFE) within three days of your application. In fact, many lenders will send you a GFE if you simply request it – before you submit a full, detailed application. The GFE will show you the yield spread premium, or commission, that's going to a mortgage broker. I don't have a problem with a broker receiving as much as a 1% yield spread premium for his or her work. Too often, though, brokers can receive outrageous fees – at the expense of naïve homeowners.

Even some brokers admit they've seen widespread fleecing of customers getting home loans.

Mortgage broker Daniel Bedford says he's seen other brokers rip off customers by charging excessive points – often by slipping in a yield service premium that most homebuyers were unaware that they were paying. "I knew a guy who made $50,000 one month (off excessive fees), and went out and bought a Mercedes," Bedford says.

"Minorities get taken advantage of a lot more than Caucasians," Bedford contends. Ironically, he notes, minority professionals are the ones more apt to take advantage of minority customers of the same race – a phenomenon known as "affinity fraud" – because consumers are often more trusting of someone with whom they share certain ties, such as race, religion or membership in a common social organization.

"Unfortunately, I've seen the good and bad in this business – especially with foreigners who come here and get taken. If the broker and the homebuyer are the same nationality, it's worse," Bedford says, revealing "I once saw an Indian broker take an Indian customer for seven points on loan."

Needless to say, abuses in the mortgage world are hardly restricted to the universe of mortgage brokers. But I share Bedford's comments with you so that you know what to watch out for.

Despite the criticisms leveled at mortgage brokers, some people swear by them, especially in an environment where banks are imposing tougher credit standards and other qualifications. Proponents say brokers are better equipped to find you a great deal on a mortgage – simply because they work with so many lenders and keep abreast of the variety of loan products being offered in the marketplace. By contrast, if you deal with a mortgage banker or a direct lender, you are limited to the loan products – and rates and terms – offered by those specific institutions.

In the end, it's difficult to generalize about whether it's better to go with a broker, mortgage company or direct lender. It really boils down to where you'll get the most attractive loan. Personally, I've obtained mortgages on different properties through all three types of lenders, and have been able secure favorable interest rates and terms from each.

Advantages of Using Direct Lenders

There are several advantages to dealing with a direct lender. These are the "household names" of the home-loan industry, such as Bank of America, Countrywide or Wells Fargo. First, if you choose a large institution or a well-established financial entity, you have the comfort of knowing that you're not dealing with some fly-by-night entity. Many borrowers pick big, direct lenders primarily to have the security in knowing that if you call, email or write that lender, you'll always be able to reach someone – without worrying whether the company has gone out of business or something. Working with a direct lender may also mean a speedier closing, since you cut out the time and processing done by a broker-middleman. Another plus with direct lenders: they may offer special deals that they're able to offer direct-to-consumer – deals they won't offer through brokers. Lastly, dealing with a direct lender may save you money because you might not be nickel and dimed to death with so many of the fees that brokers often impose.

5 Smart Questions You Must Ask About Your Mortgage

When you apply for a loan through a broker, mortgage banker, or direct lender, make sure you ask the following five questions:

- **What is the interest rate and the Annual Percentage Rate (APR) on this loan?**

Many consumers make the mistake of shopping for a mortgage loan based solely on the interest rate. This is a big mistake for several reasons. First, it doesn't tell you about key terms that affect the loan – like whether or not it has a prepayment penalty. Also, when you look exclusively at the interest rate – and not the Annual Percentage Rate on a loan – it doesn't tell you the true borrowing costs you'll pay for a mortgage. The interest rate is a starting point. But the APR will always be higher than the interest rate, because the APR factors in all the costs of the loan – like points, loan origination fees, and other charges. Expect to see a difference of .5% or less in the interest rate you're quoted and the APR. If the gap between the two is greater than .5%, it means the loan has high fees, so you may want to seek a better deal elsewhere.

Be aware that lenders can't accurately figure out an APR for an adjustable rate loan. If you apply for an ARM, make sure you know how frequently the interest rate can adjust. Is it every month, every six months, one a year, or some other time frame? Ask also about the maximum amount of percentage points the rate can increase in any given year, as well as the overall "cap" on the loan, which is the absolute highest interest rate you could ever have to pay.

- **Are there Points charged on this loan?**

A "point" is a fee that equals one percent of your loan amount. Lenders allow you to pay a point – sometimes called a discount point – in order to get a lower interest rate. While it might sound like a good idea to pay a one-time fee upfront in order to "buy down" your interest rate, in reality, paying points is frequently a money-losing proposition. You should avoid paying points because, in most cases, for every one point you are charged, your interest rate is only knocked down by 1/8th of a percent, or maybe 1/4th of a percent. So in my opinion, it's not worth it to pay points. A quick example will illustrate this concept. Assume you can get a $250,000 mortgage at 7% interest with no points. Then the lender offers to let you pay one point, or $2,500, to lower your interest rate by 1/8th of a percent to 6.875%. The monthly payment on the no-point loan at 7% would be $1,458 a month. Meanwhile, the monthly payment on the loan with one point, at 6.875% would be $1,432, a difference of $26 a month. If you divide the $2,500 cost you pay for one point by $26, you'll get 96, which is the number of months required for you to "break even" on those points you paid. So you'd have to live in your house for 96 months (i.e. eight years) in order to recoup that one point. If you sold or refinanced before then, you lost money by paying that upfront point. The one upside to paying points is that they are tax deductible. But ideally, you shouldn't pay any discounts points on a mortgage. Have the lender quote you a rate that's based on a loan with zero discount points. If you shop among multiple lenders, having everyone quote you a rate based on zero points will also make it easy for you to make an apples-to-apples comparison of the loans you're being offered.

- **What are all the costs for this mortgage?**

The Good Faith Estimate you receive from a lender will outline all the costs you must pay in connection with your mortgage. Some fees are imposed by the lender. Others are charged by third parties, like attorneys, title insurance firms or appraisal companies. Make sure you know all the fees you'll be expected to pay, so you don't have sticker shock at the closing when you see a laundry list of charges that may have not been previously disclosed. Ask your lender to guarantee their Good Faith Estimate – meaning that they won't increase the charges that they assess. A lender doesn't have any control over what outside parties charge, but they can stand behind their estimates of what fees they assess.

- **Does this loan have a pre-payment penalty?**

Ideally, you want to hear the answer "No." In fact, some states, such as New Jersey, restrict lenders from imposing prepayment penalties, which allow lenders to charge you hefty fees any time you refinance your loan or pay it off early. Prepayment penalties can run as high as six months worth of payments, so you should definitely avoid them if at all possible. Some people believe pre-payment penalties can be useful to those who know they'll stay in the house for a long period of time since lenders will sometimes offer you a lower rate on a loan that includes a prepayment penalty. But my thinking is: why be saddled with a loan with potentially harmful terms if you can get an equivalent loan without those terms? The Truth in Lending statement that you receive from a lender will indicate whether or not you loan contains a prepayment penalty. Sometimes, the form will have unclear language, and will state something like "This loan may have a prepayment penalty." That can be interpreted either way – that a prepayment penalty could be imposed, or may not be imposed. Should you encounter such language, tell your lender you want it to be explicitly stated that your loan "does not have a prepayment penalty." If necessary, write in such a statement yourself and initial it.

- **How much, if anything, will it cost me to lock in my interest rate?**

Interest rates change every day. If you've got a good rate, and you are worried about rates going up, you may want to lock in your rate to protect yourself against rising interest rates. Many lenders will allow you to lock in your rate free of charge for 30 days – and even 45 days. This may be plenty of time to close on your mortgage – especially if you've already been pre-approved. But if you think you'll need more than a month or so, you may have to pay a fee for a 60-day rate lock. The fee can be as much as one percent of your loan amount. If you do lock in your rate, always get it in writing – don't just rely on someone's word that your rate is guaranteed. It's not, unless you have written proof of it.

Recognizing Junk Loan Fees from Reasonable Ones

No matter which entity you choose for financing, getting a mortgage loan involves paying a whole host of fees beyond a down payment. Your closing costs will include a litany of charges ranging from one-time fees for things like credit checks to annual expenses that you pre-pay upfront, such as homeowner's insurance. Here are examples of the common fees you might see when you obtain a mortgage – along with estimated costs for them. Obviously, prices for different products and services can vary based on where you live and other factors. Nevertheless, the numbers presented below will give you an estimate – or in some cases a range – of what you can typically expect to pay for your mortgage.

- **Typical Closing Costs on a New Mortgage:**

Description of Fee	Cost
Application Fee	$150-$400
Appraisal	$200-$400
Closing Fee	$250-$350
Credit Report	$15-$50
Document Prep Fee	$150-$300

Flood Certification	$25-$100
Legal Fees	$400-$1,000
Loan Origination Fee	Usually 1% of the loan
Points	Each point is 1% of the loan
Recording Fee	$25-$50
Survey	$200-$400
Taxes	Varies (See more info below)
Termite Inspection	$100-$200
Title Insurance	Varies (See more info below)

Some loan costs – like interest on your loan and property taxes – must be escrowed, meaning that you pay for them for a year in advance. The same is true for homeowners' insurance, which covers the house in case of a fire or another disaster.

Other insurance you have to pay for includes title insurance, which is an indemnity policy that provides protection against any loss that arises due to problems with the title (or ownership) of your property. Lenders require you to have title insurance because if the title is "faulty" – due to a tax lien, judgment or some kind of encumbrance on the title – then title insurance covers the lender. As is the case with mortgage insurance, you bear the costs of title insurance (in a single, up-front payment), but your lender receives the protection for this coverage.

Title insurance costs vary greatly nationwide, partly because the title insurance premium you pay often covers different services depending on the company you use and where your home is located. For example, in some place your premium simply covers the lender for any title-related losses. In other places, though, the premium covers losses, as well as the cost of a title search, title examination, and closing services. Title insurance also varies based on the size of the mortgage.

Junk fees are those charges imposed solely to add to a lender's profit margins. In many cases, these fees have formal or sometimes very official-sounding names, like "document preparation fee." But in truth, they're really just creative ways for lenders to pad their bottom line – at your expense. Many lender charges that have the word "fee" slapped on the back of them are a dead giveaway that you're being charged for services that lenders are supposed to provide anyway. So if you get charged for an "underwriting fee," a "loan review fee," a "warehousing fee," or other such nonsense, I would not hesitate to ask the lender to waive those fees – or at least substantially reduce them. Even things like the "application fee" or the "loan processing fee" can be eliminated or cut, if you are savvy enough to ask.

How to Protect Yourself from Excessive Loan Charges

One way to protect yourself from excessive loan charges is to simply know what's loan services are customary – and what the going rates are for those services. The previous section in this chapter gave you those insights. Being familiar with the law can also help you avoid unfair or exorbitant loan fees. For instance, The Real Estate Settlement Procedures Act (RESPA) protects you by prohibiting "kickbacks" – including referral fees among settlement providers – which can make getting a house more expensive. Additionally, you can save money by shopping around, particularly by comparing interest rates and loan terms online. Lastly, you can get the help of outside professionals to tell you whether you're getting a suitable mortgage. That way you have a third-party's opinion about your loan – and you don't have to relay on loan officers who will almost invariably say: "Trust me. This is a great deal."

- **Get price quotes from Internet auction sites**

On these sites, you'll fill out a questionnaire, answering a slew of questions about your personal finances, the property you intend to buy, and the type of loan you're seeking. After you fill out the required information, your request is sent to a handful of lenders, who will get back to you with mortgage offers. Just be aware that direct lenders, brokers and mortgage banks can all supply "lowball" price quotes – just to entice you to call them and start the loan application. But they're not bound to honor that initial rate quote, and indeed, few do.

Some Internet sites where you can get preliminary rates quotes are:

- Cityloans.com
- Eloan.com
- Lendingtree.com
- Loanweb.com
- Lowestmortgage.com
- Mortgageexpo.com

When you shop for a mortgage online you streamline the process, save time, and are more readily able to make an apples to apples comparison of the loans you're being offered. The advantage of getting online mortgage information is that you can receive multiple quotes on the same day, at the same time. By contrast, if you got on the phone and called five lenders, the process would be far more time-consumer and in between calls, rates could change.

Brokers in a group called the Upfront Mortgage Brokers guarantee their fees and disclose the wholesale costs of loans they offer. You can get a list of these brokers at http://www.mtgprofessor.com. Likewise, this site also lists a few Upfront Mortgage Lenders, who also disclose and guarantee their fees when you apply for a loan – and not just at closing. Some of these lenders include Eloan.com and Amerisave.com.

Get An Objective, Professional Evaluation of Your Loan

Getting an outside opinion of your mortgage offer is also a great way to independently check the suitability of that loan. Fortunately, this is now possible with the emergence of a handful of companies that will review your loan offer and give you feedback on it. One of those firms is Offer Angel (http://www.offerangel.com), an online mortgage advice site that launched in May 2007.

"We are completely consumer driven," says Meghan Burns, co-founder of OfferAngel.com. "We're most concerned about educating the public and making sure they understand not just the rates and terms associated with their mortgages, but also the suitability of the loans they have."

According to Burns, far more people are being stuck with sub-prime, predatory loans than is necessary.

"When you say 'sub-prime loans,' people immediately think those loans are going to uneducated or low-income people, but that's just wrong," Burns says. "There are doctors and lawyers making tons of money that have sub-prime credit."

She adds that predatory lending isn't just being charged a high interest rate, or being assessed a pre-payment penalty.

"Essentially it's somebody taking out a loan at a cost that's higher than what they qualified for," Burns says.

To fight that problem, and to educate you about your mortgage, OfferAngel.com will evaluate your loan for you – free of charge, or for a nominal fee. Here's how it works. Offer Angel is an open access site, accessible to consumers and loan originators. Your loan officer fills out a form that contains information about your proposed mortgage. OfferAngel.com asks for details – what Burns calls the "nitty gritty of the loan being offered."

The loan officer must indicate information such as whether or not the loan is fixed rate or adjustable, and whether it has a pre-payment penalty or not.

"We want factual data," says Burns, who is a former mortgage loan officer. "Our system is not easily manipulated. The answers are either yes or no." Based on the information your lender presents, Offer Angel gives you a free report that analyzes your mortgage. The company's complimentary side-by-side mortgage report actually lets you compare up to four loan officers. The free report also includes explanations about basic loan terms.

For $24.95, Offer Angel gives you more detailed analysis, in the form of a Personalized Mortgage Report. "We never say: this is the lender you should go with," notes Burns. But the company does warn you about mortgages that may not meet your stated needs and goals. For instance, if you say you plan to live in the house for just three years, and the loan contains a five-year pre-payment penalty, OfferAngel.com will alert you to that fact. Or let's say you've indicated that you want a fixed interest rate, but the loan being offered is a 7/1 ARM. In such a case, OfferAngel.com would flag this and tell you that this loan's interest rate is likely to change. The Personalized Mortgage Report is designed to alert you to high costs in your loan or terms that might make your loan unfavorable right now – or down the road.

To use Offer Angel, you simply submit your name, email, and the state in which you live. You don't have to disclose personal information, like your social security number, address or phone number. Equally important, Offer Angel does not push one lender over another, it does not sell or share your information, and it doesn't make mortgage loans or act as a "lead generator" for others trying to sell you a mortgage. So if you're still not sure whether you're getting a suitable mortgage, get help from a neutral, third-party source like OfferAngel.com.

Common Mortgage and Home Buying Scams to Avoid

Now I have to tell you about a pitfall you need to avoid while you're trying to land your dream home: scams perpetrated by home sellers, real estate agents, loan officers and others.

Each of these scams also has a common thread – a buyer who goes along with the con, either knowingly or unwittingly. Therefore, you should know about these illegal schemes in order to avoid them, and keep yourself out of trouble financially and legally.

- **Pretending Someone Else's Money is Your Own**

Some desperate would-be homebuyers will try to fake out a bank by "borrowing" someone else's bank account to get a mortgage. These consumers know that banks like to see cash reserves in an account. So the customer will ask a friend or family member to dump some money – just temporarily – into the homebuyer's checking or savings account to help the buyer qualify for a loan.

This constitutes mortgage fraud, because you are knowingly supplying false information on your loan application.

- **Artificially Inflating The Sales Price of the Home**

If anyone ever suggests that you take part in a real estate transaction where the price of the home is faked for any reason, do yourself a favor and stay away from that person. In desperate times, or when market conditions are weak, people dream up all kinds of home frauds, most often in an effort to defraud a bank. A fake appraisal may be obtained. A buyer and seller may agree on a sales price that's higher than the current market value or above the seller's initial asking price, so that either the seller or buyer (or both) can get extra cash from a lender at closing. This deceptive practice is illegal and you should not engage in these kind of shenanigans for any reason.

- **Faking Documents Of Any Kind**

Watch out also for anyone who gives you fake documents, or encourages you to supply fake documents to someone else. The documents a seller might try to pass off legitimate are false appraisals, forged deeds for properties they don't own, or fake inspection reports. This kind of fraud is rare, but it does occasionally happen. What is more common is that a real estate professional might encourage you, as a buyer, to falsify documents. They might get you to fill out some bogus information online, just to get a pre-qualification letter. Or someone might ask you to lie about your income, credit history, or the number of people who may be occupying your new home.

- **Using a "Straw Buyer" to Close a Deal**

A "straw buyer" is a third party in a real estate transaction that is used to get a mortgage from a bank when the true buyer can't qualify for a loan. In a fraudulent real estate deal, the buyer and seller agree to let a third party, the straw buyer, act as a "stand in" of sorts to facilitate the purchase. The straw buyer's name may be used on a loan application, or perhaps his social security number, credit history, assets – or a combination of all these items. Using a straw buyer to conceal the real identity of a prospective homebuyer amounts to real estate fraud and is a serious crime you should avoid at all cost.

Hopefully, you won't run into any mortgage scams in your effort to get a home loan. But if you do, being an educated consumer – which means having the ability and knowledge to recognize a scam – can be the best way to sidestep this pitfall.

Even if a real estate agent, mortgage broker, or loan officer tells you to falsify information in order to get a home loan, don't do it. Bottom line: Don't take part in any mortgage scams under any circumstances, for any reasons. It's wrong, and it's just not worth it considering the risks you face of getting hefty fines and maybe even jail time if you get busted. By the way, legitimate players in the mortgage industry actively are aggressive in trying to stamp out mortgage fraud, and they encourage you to join in that effort too.

The Mortgage Banker's Association has also set up a website at: http://www.stopmortgagefraud.com in an effort to combat fraud. You can report loan abuse to their toll-free number: 800-348-3931.

The Seven Commandments for Successful Homeownership

In the previous chapter, I walked you through some of the financial planning and tax strategies you could use to effectively bolster your status as a homeowner. But as you may recall, proper financial planning represented just one goal for which all homeowners should strive. There are seven goals in total. Think of these objectives as the "Seven Commandments for Successful Homeownership."

- to always pay your mortgage on time
- to keep up with all required property taxes
- to make sure your home is consistently and adequately insured
- to maintain your home in the best possible condition
- to properly manage the equity in your house; and
- to increase the rate of appreciation on your property
- to take advantage of the financial planning and tax strategies that are available only to homeowners

We've already addressed the last issue. Now let's talk about the other ways for you to successfully preserve homeownership, avoiding foreclosure and other pitfalls property owners face. I don't want you to become a statistic in the unfolding foreclosure crisis – and I know you don't either. By adhering to the "Seven Commandments" listed above you can have peace of mind and be assured of keeping your home for as long as you want it.

Always Pay Your Mortgage on Time

It sounds like a simple enough rule: always pay your mortgage on time. Unfortunately, that's often easier said than done. Some people pay their mortgages late – that is, after the due date – but before the grace period on their mortgage expires. This could be due to carelessness or a simple oversight on their part. The good news is that banks often give home borrowers a 10 or 15-day grace period on mortgages before a late charge is imposed.

- **Set up Automatic Mortgage Payments**

Avoid the mistake of accidentally getting your payment in the mail, or forgetting to make a payment by setting up your mortgage on an automatic payment system. Have the money come right out of your checking or savings account each month to bypass the hassle of getting stamps and writing a check for your mortgage. Instead, just let the payment get electronically deducted. This way, if you are traveling, if your spouse neglects to pay the mortgage, or if for some reason you're not around to mail off a check, then your house payment will still get made.

- **Prioritize Your Bills**

We all have a laundry list of financial obligations – from house payments to utility bills to food and clothing expenses. Throw in transportation, various kinds of insurance, and the cost of raising kids and you can easily see how all those bills can really add up. No matter what debts you have, always think of your mortgage as top priority in terms of items to be repaid. If push comes to shove, you can work out a deal with your cell phone carrier and pay that large, unexpected cell phone bill you received over a few months. But you never want to get behind on your mortgage. Pay that house note first, then put other debts such as credit cards, auto loans or student loans next in order of importance. If you're delinquent on any of these debts it can hurt your credit – a fate you definitely want to avoid.

- **Establish a Cash Reserve**

You'll recall that in an earlier chapter of Your First Home, I explained why having a cash cushion was vital for homeowners. Once you get into a house, having extra cash on hand to deal with emergencies or unanticipated events can mean the difference between making your house payment on schedule or being delinquent on your mortgage. If something happens that impacts your finances – like you lose your job or suffer an illness that leads to bill medical bills – you'll be counting your lucky stars that you had the foresight to stash away some money for a rainy day.

Keep Up With All Required Property Taxes

Missing mortgage payments isn't the only way you can lose your home. Falling behind on your property taxes also puts you at risk of foreclosure. In fact, tax lien foreclosures take place every day in America. When you don't pay property taxes you owe, your city or county has the legal right put a high-priority tax lien on your property in the amount of the past due taxes, plus interest and penalties. After a set period of time – typically anywhere from six months to two years, depending on where you live – if your taxes are still unpaid, the taxing authority's tax lien gives them the right to foreclose on your property. Your home then gets sold at an auction to anyone willing to pay off the back taxes due. Lots of investors buy "tax lien certificates" in the hopes of getting a home in tax foreclosure. For these investors, it's a way for them to purchase a home at a fraction of its value – without even having to pay off the mortgage due on the house.

The number one reason people become delinquent on their property taxes is because these taxes can run into the thousands, driving the true cost of homeownership up considerably. Check out the taxes paid in the following 10 states, which have the highest property taxes in the country. You'll notice that the top five states with the biggest tax bills are all located in the Northeast. But even Midwest states, such as Illinois, and Western states, like California, all make the list.

State	**Median Property Tax**
1. New Jersey	$5,352
2. New Hampshire	$3,920
3. Connecticut	$3,865
4. New York	$3,076
5. Rhode Island	$3,071
6. Massachusetts	$2,974
7. Illinois	$2,904
8. Vermont	$2,835
9. Wisconsin	$2,777
10. California	$2,278

Source: Census Bureau, Tax Foundation

Even if you live in a community with high property taxes, there are some smart ways to go about lessening your tax burden – and subsequently keeping your home.

Proven Strategies to Slash Your Property Tax Bill

Almost everyone hates to pay taxes, and it doesn't matter whether they're federal income taxes, state taxes, or local taxes on the house you own. But Americans dread property taxes more than any other tax, according to the Tax Foundation, a Washington, D.C.-based research group. Not to worry. If you tax bill is particularly onerous – or out of line with what others are paying for similar homes – you can often make a case for why your taxes should be reduced. To slash your property tax bill, try these tried and true techniques.

- **Analyze Your Property Tax Card**

As a homeowner, you're entitled to visit your local tax assessor's office and request a copy of your property tax card. This tax card contains detailed data about your house, such as the lot size, the number of bedrooms and bathrooms in your home, as well as information about improvements or upgrades to the house. If you find mistakes in this card, point it out to your tax assessor and request a re-evaluation. That re-evaluation could lead to your annual tax bill being lowered.

- **Know the Tax Implications of Home Additions**

Many homeowners want to improve or beautify their houses – or simply make their residences much more livable. Before you satisfy your hankering for a new pool, an extra bathroom, or even a new storage shed in the backyard, find out how such an addition or structural change would impact your property taxes. Any permanent structures you build – such as a deck or additional bedroom – will wind up adding to your tax bill.

- **Compare Neighboring Properties to Your Home**

Not only can you get tax information about your home, you can also research your neighbors' homes too. This can be invaluable if you approach a tax assessor's office to ask for a property tax reduction. Let's say you notice that the taxes on your three-bedroom, two-bathroom home are higher than all other three-bedroom, two-bath homes in your area. This gives you a factual basis upon which you can make a claim that your taxes are too high.

- **Deal Honestly With Your Tax Assessor**

If you ask for your property bill to be lowered, expect your local municipality to try to schedule an appointment with you for a tax assessor to come out and inspect your home. Some people try to dodge the tax inspector, afraid that this person may see nice things in the home or quality amenities, and raise their property taxes. If you've done your homework, and you're dealing in a forthright manner with the tax man, don't worry too much about a tax increase. On the other hand, some cities automatically impose the highest tax rate possible on a home if a property owner refuses to grant the tax assessor access. So when the tax assessor comes to your house, whether the visit is scheduled or not, just graciously welcome the person inside. Be sure to walk through the home with him or her – pointing out the good and the bad in your house. The tax assessor may note your nice hardwood floors or the granite countertop in your kitchen, but may miss the fact that your house doesn't have new replacement windows or updated appliances. It's your job to candidly point out these flaws – without going overboard. Just be matter-of-fact in mentioning your home's high points, as well as all of its drawbacks.

- **Keep Up With Current Market Values**

One big reason that property taxes exploded during the past decade is because home prices escalated so dramatically. Since skyrocketing home values led to re-assessments on the upside, in theory, declining home values can also lead to lower assessments. Therefore, keep abreast of local market values. If you live in a community or a state where prices have stagnated or fallen substantially, you may be due for a reduction of your property taxes. Just realize that reassessments, (excluding those done when a home is sold), typically lag behind local market conditions.

Make Sure Your Home is Consistently, Adequately Insured

When you obtained your mortgage, your lender undoubtedly required you to have property insurance. Homeowner's insurance covers your house in the event of a fire or some other catastrophe. In some states – such as earth-quake prone California, or hurricane-prone Florida, insurance premiums can run in the thousands of dollars each year. Despite the cost, you always want to make sure your home is adequately protected. It can be disastrous if you let your insurance coverage lapse and then suffer a calamity like an accidental house fire. Expect basic insurance coverage to cost you at least $500 to $1,000 per year. To get proper insurance coverage at the best rates possible, follow these five suggestions.

- **Increase Your Deductible**

The rule of thumb with insurance of any kind is that higher your deductible, the lower your premiums. By increasing your deductible from $250 to $500 or from $500 to $1,000 you can typically shave 10% off your homeowner's insurance premiums. A higher deductible means that you won't be able to make smaller claims with your insurer – say if a window gets broken or a pipe leaks causing a modest amount of damage. The upside, though, is that you'll keep your rates low with a squeaky-clean claims record.

- **Buy Smoke Alarms**

Purchasing a smoke alarm isn't just a smart thing to do to keep your family safe. It's also a low-cost way to save money on your insurance. Smoke alarms are cheap, just $10 or $20. but these life-saving devices can slash another 10% from your annual insurance costs.

- **Install a Security System**

By putting in a burglar alarm in your house – especially one that's linked to your local police station – you can cut your insurance costs by roughly 5% to 10%. To get this discount, send a copy of the bill for your burglar alarm or proof of your security system contract to your insurer.

- **Ask for a Multiple Policy Discount**

If you have an auto insurance or health insurance with one particular insurer, it may pay off to place all your insurance coverage with that company. Ask your insurer about a multiple policy discount, which is given to consumers who give all their insurance needs with one insurer. The upshot is that you might also get a multiple policy discount on your auto and health insurance too – saving valuable dollars on that coverage as well.

- **Comparison Shop Annually**

Experts recommend that you review your homeowners insurance regularly in order to make sure your current coverage adequately meets your needs. Mark a date on your calendar to do a once-a-year policy review. When you do your annual insurance check up, make sure you comparison shop to see if you can get better rates elsewhere. Insurers eager to win over new business may offer good deals to new customers. It's fast an easy to compare insurance rates online at sites like: http://www.insurance.com or http://www.insure.com. Whatever company you choose, protect yourself by only buying a policy that offers "Guaranteed Replacement Value" insurance. This means that if disaster strikes and your home gets completely destroyed, the insurance company will pay you the full current market value for your home – not just what you paid for your house.

Maintain Your Home In the Best Possible Condition

Have you ever driven through an older, established community and seen homes in disrepair? You know what I'm talking about: those nice big, but shabby-looking homes you can find in practically any working-class or middle-class community in America. Maybe the porch has gotten dilapidated or the 40-year-old roof needs replacing. Or perhaps a home is in desperate need of a paint job or even just a decent trim of those overgrown hedges and a good mowing of the front yard, which now resembles a mini forest.

Viewing the outside of some of these residences, you can just imagine how they must have looked back in their prime. They were probably elegant and stately, with well-manicured lawns and eye-catching exteriors. Unfortunately these homes are now anything but eye-catching. In fact the words "eye sore" are far more appropriate.

What happened? In some cases, homes were passed along from one generation to the next and the recipients of the houses were unable to afford proper upkeep. At other times, properties fell into disarray after their owners experienced a host of personal problems, ranging from job loss to divorce to medical illness. And in certain instances, property owners simply neglected their homes, allowing them to look more like caves than castles.

If you want your home to truly be your castle, you must treat it with the tender loving care it deserves. The payoffs for doing so are enormous. Not only will you enjoy living in the home, but you'll help maintain or increase the value of the house, as well as give yourself more financial options if you ever need to sell or tap into the equity in your home.

Believe it or not, many of the people caught up in the foreclosure wave right now have shot themselves in the foot simply because they haven't properly maintained their homes. Some unsuspecting homeowners, when faced with financial difficulties, mistakenly thought they would be able sell or refinance their homes. But when appraisers and inspectors visit a home and find all sorts of problems – such as a leaky roof, broken windows, or electrical problems – these issues can derail a deal in no time flat.

You can avoid a lot of headaches and financial problems simply by regularly tending to your property and giving it routine care. Think: pick up, clean up, and repair.

Start by getting into the habit of walking around the perimeter of your property at least once a week. We all have a tendency to enter or exit our homes the same way. Sometime we leave via the front door. But many people, especially those who own single-family detached homes, frequently leave their houses via their cars, exiting from a garage. By doing so, you can miss issues large and small. Is there some rusty soda bottle that the wind blew onto your side lawn? Or did the neighbor's garbage or recycling somehow spillover onto your property? It may be someone else's trash but now it's your problem. So minimize trash and other miscellaneous objects outside your house simply by picking up things outdoors on a regular basis. I'm not asking you to go overboard. No need to go turn into the town trash collector. But at the very least you should do your part to keep the outside of your house looking decent and in order. If you happen to walk by a neighbor's property and they have something lying on the ground that shouldn't be there, it wouldn't hurt you to pick that up either. You'll be beautifying the community, and who knows, your neighbor may one day return the favor.

As you survey your proper, remember that outside issues can trickle indoors if problems aren't addressed. Keep your gutters clear of leaves, so you don't have interior leak problems. Think of your home as you would your automobile. Every moving part needs some kind of attention at some point or another. If your doors squeak, lubricate them. If your window screens are tattered or ripped, replace them.

Power washing is a great way to beautify any patio, walk way, entrance, front door or exterior. If you house is vinyl sided or brick-faced, chances are you can power wash. You can rent a power washer from your local home improvement store or hire an expert to do it for you for just a few hundred dollars.

Properly Manage The Equity in Your House

I've already explained how the equity in your house represents a source of personal wealth. It's an asset you don't want to squander for any reasons. To avoid that misstep, it's vital to understand how to properly manage your home equity and make sure it continues to grow.

There are three primary ways that the equity in your house builds: by paying down the principal owed on your mortgage, through natural market appreciation, and by making property improvements that increase the value of your house. As a homeowner, you have no control over whether or not the real estate market goes up or down. But you can bolster home equity by reducing your mortgage balance and making smart choices about home improvements.

So let's start with the strategy over which you have the most control: the rate at which you pay down your mortgage. Under normal circumstances, you make a monthly payment to your lender and little by little your outstanding principal balance begins to dwindle. I said "little by little" because during the early years of your mortgage, most of the monthly payments you make are applied toward interest. For instance, after 10 years of paying on a 30-year mortgage, you're likely to have knocked off just 13% to 17% of your principal balance. Once you get into the 18th or 19th year of your mortgage, that's when you start really making headway on your loan. It's at that point when you'll discover that more than half of your payment gets credited toward reducing your principal outstanding. This is typical for a loan that amortizes over 30 years.

But what if you wanted to accelerate your loan payoff? You could do so in any number of ways. You can send your lender additional money each month – in any amount of your choosing – and write a letter to your bank specifying that you want those funds applied to your principal balance. You can also remit one extra full payment on your mortgage each year to hasten your mortgage payoff. Both are powerful strategies that rapidly reduce your mortgage debt and save you tens of thousands of dollars in interest charges. Assume you took out a $400,000, 30-year loan for a home at an interest rate of 7%. Your monthly payment for principal and interest would be $2,661. By adding an extra $300 a month to your payment, you can pay off your mortgage in just 22 years and four months. You'd also save an incredible $168,392 in finance charges. Similarly, by making one extra payment of $2,661 each year, you would be mortgage-free after 23 years and 10 months, and would save $134,177 in interest. Equally important, both scenarios allow you to dramatically increase the equity in your home.

As a homeowner – especially one who has a good deal of equity in your home – you need to be prepared for the onslaught of come-ons you're apt to get from lenders of all stripes. All kinds of banks and financial institutions will flood your mailbox with loan offers, each of which will encourage you to tap into the equity in your house. You'll find these offers particularly plentiful when home prices are rising. Some lenders will want you to refinance your house. Others will suggest you take out a home equity loan or home equity line of credit. If you say "Yes," to any of these offers, realize that those loans are secured by the value of your home. Thus, any additional mortgage debt you acquire diminishes the value of your home equity.

I don't mean to suggest that you should never refinance your house or take a loan against it. One the contrary, both refinancing and home-equity loans can be prudent strategies – when done carefully and for the right reasons.

, you'll find that your mailbox is full of offers from banks and other financial institutions that are all-too-eager to

Home equity loans appeal to property owners for several reasons. First, they're fairly easy to come by, since your house is collateral for the loan. Additionally, the interest on home equity loans is generally tax deductible up to $100,000. Moreover, the interest rates you pay on home equity loans and lines of credit are typically lower than other consumer loans. Lastly, you could use the money for any purpose you want, such as: making home improvements or paying down high-rate credit card debt.

Despite all of these attractive features, you must take care in both applying for and using a home equity line of credit. For starters, you don't want to use your home as a piggy bank, tapping your equity for the wrong reasons, like to pay for vacations, cars, holiday spending and the like. Resist the temptation to borrow more than you can afford or more than you really need. If you've ever been seduced into spending money on a credit card with a high credit card limit, think of how you will deal with the temptation of having a big home equity loan or line of credit at your disposal.

What Nobody Tells You About Home Equity Loans

Speaking of credit cards, did you know that a home equity line of credit operates very much like a credit card? Both of them have a pre-set limit and each allows you to access your credit by simply drawing down on your credit line. With a home equity line of credit, you access your available funds by writing a check or using a card that you lender provides. In this manner, you only make payments each month based on the amount of credit you've utilized.

A home equity loan works differently. You receive a lump sum amount of cash to spend on what you'd like. And because you receive the money upfront, you start repaying the entire loan balance back immediately. Therefore, you could have a $100,000 home equity line of credit, spend just $15,000 from that credit line and make principal and interest repayments based on those $15,000 worth of charges. With a $100,000 home equity loan, all the funds are immediately disbursed to you and your repayment is based on the full amount of your loan.

Most bankers will tout the tremendous benefits of home equity lines – and indeed, it can be advantageous to be able to pull cash out of the value of your house. But relatively few lenders will warn you about the pitfalls of home equity loans, or of the dangers of unnecessarily or unwisely draining your home's equity. So what are the downsides to these loans?

For starters, they're not like unsecured credit cards where, if you don't pay, creditors have fairly limited recourse against you. With a home loan, your house is on the line, so if you don't repay an equity loan or line of credit, you could lose your biggest asset.

Home equity lines of credit also frequently carry variable interest rates. This means what starts out as a manageable payment could quickly rise on you if you're not careful.

Additionally, home equity loans aren't always the best way to borrow. In certain instances, it may make better sense to use other forms of financing. For example, if you're thinking about using a home equity loan to pay for college expenses, you should first explore traditional student loans. They may have better lower rates, and the interest on many college loans is tax-deductible as well. Moreover, when you or your child secure federal student loans – like a Stafford Loan or a Perkins Loan – these are often subsidized, meaning the government pays the interest on the loans while the student attends school.

Another point of note: while the government uses tax benefits to stimulate homeownership, Uncle Sam's generosity for property owners only goes so far. So that equity loan or line of credit you take out will only be tax deductible up to a maximum of $100,000.

Lastly, home equity loans can sometimes give you a false sense of security, making you feel a bit "richer" than you are and leading you to make unwise spending choices or even extravagant purchases. For all these reasons, think long and hard before you open a line of credit secured by your home.

I'm often asked if it makes sense to use a home equity loan to pay off high rate credit card debt. My answer is: Yes, if two specific conditions are met. First, you have to identify how it is that you got into a mess with credit card bills. If you racked up credit card bills because you fell victim to one of the Dreaded D's – Divorce, Downsizing, a Death in the family, Disability or Disease – then you should consider using a home equity loan to pay off those credit card bills. If, on the other hand, you simply have a shopping addiction, or if you lack proper money management skills, I wouldn't recommend taking out a home equity loan to payoff credit cards. In such instances, people usually just wind up with far more mortgage debt – and they go out and run up the credit cards all over again. The second condition for using home equity to reduce credit card debt is: has the problem that caused your debt been fixed? Even if you got into debt through no fault of your own – because of a down sizing or because you and your spouse split up – the fact remains that it's a bad idea to put your home at risk if those issues haven't been resolved. If you've got a new job, have financially rebounded from a divorce, or have beat a disease or disability that left you previously unable to pay your bills, that is a different story. In these instances, by all means, get caught up on your debts by paying off those credit card bills with low-rate, tax-deductible mortgage debt.

Do's and Don'ts When Refinancing Your Home

After owning your home for some time, you may start to consider whether or not you should refinance your mortgage. If interest rates have dropped considerably, or if your credit has improved dramatically, it's possible you may be able to get a much better deal on a new mortgage than your original loan. Before you commit to a refinancing, however, make sure you realize the implications of doing so.

To begin with, refinancing can eat away at your home's equity because refinancing is not free. A refinancing entails paying off your old loan and replacing it with a new one, and banks aren't in the business of making loans free of charge. Even if you hear lenders talk about a so-called "no cost" refinancing, don't believe it. A lender may not have an application fee, or may not charge you points to do a refinance, but those costs are essentially priced into a loan with a higher interest rate. As you've heard many times before, "There's no such thing as a free lunch."

You probably remember that points your pay to obtain a mortgage are tax deductible. When you refinance, however, any points you pay must be amortized over the life of the loan. In other words, you can't take the full deduction for the points in one year, as you can do when you buy a house.

As with a home equity loan, you should never refinance into a larger loan than is necessary. Unfortunately, scores of homeowners do this all the time when they sign on the dotted line for a "cash out" refinance, which allows you to not only get a better rate or more favorable loan terms, but which also allows you to get some dollars back in the deal as well. A cash out refi saps equity from your home, so you should only take that money if you plan to use the proceeds wisely. Guard against frequent refinancing too. If rates drop a half point or even a full percentage point, do the math to figure out if any monthly savings you can generate will really outweigh the closing costs and other fees associated with a refinance.

As with all financial products, you should shop around for the best loan terms you can get in the event you do decide to refinance your mortgage. Don't just accept the first offer that comes your way. In considering a refi, follow the same vigilant standards you used to evaluate lenders and their offerings when you bought your house. This means you should know the annual percentage rate on your new loan, all fees charged, as well as key payment terms, such as whether a prepayment penalty exists.

Don't ever sign any loan documents that you don't understand. And say "No" if any loan officer or mortgage broker asks you to put your signature on a blank document with the promise that he or she will fill it in later. You don't know what they could insert in those loan documents. Also, make sure you get copies of everything in connection with a new mortgage: this includes a Good Faith Estimate, a Truth in Lending form, as well as the mortgage, note and/or promissory document you must sign.