Loan Terms, Problems and How to Avoid Them

There are several different types of mortgage loans. In most cases, a fixed rate mortgage is preferred. With a fixed rate mortgage loan, your monthly payments will go towards both principal and interest and you will pay the same dollar amount every month for the entire life of the loan, with the exception of small changes due to fluctuations in tax and insurance rates. There are no surprises.

An adjustable rate mortgate (ARM) requires monthly payments which include principal and interest, but the monthly payment amount can change significantly over the life of the loan. This change generally results in higher monthly payments later.

We do not suggest interest only loans; any monthly payment plan you enter into should cover both interest and principal.

Don't pay too high an interest rate. People who don't shop around often pay a higher rate than they should. The difference between a 6% and an 8% loan on a $100,000 house is $134.21 per month. Over the life of a 30-year mortgage, that's $48,000!

- So first, find out your credit score:
- 600 or higher, along with factors such as job stability and good credit history, should get you an "A" or FHA-type loan.
- 500–600 means you'll pay an extra 2–3%.
- Less than 500—WAIT! You will not get a good deal on a mortgage loan.

Don't pay too much in closing costs. These include property taxes, transfer tax, insurance, attorney fees, application (loan processing) fees, origination (underwriting) fee, document preparation fee, broker fee, discount points, appraisal fee, credit report fee, title search, recording fee, survey fee, flood certification fee, courier fee and notary fee.

- They range from about 3% to 5% of the total cost of the house, but can sometimes be higher depending on whether you use discount points, have an escrow account set up, and other factors.
- Do not pay more than $400 in "up front" fees for an appraisal and your credit report.

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To get a good deal on a house, pay the right price, get a fair loan and be able to afford to live in the house for years to come.

This brochure* helps you identify a fair loan. There is no one type of loan that is right for every buyer. Loans vary based on your income, your credit and your reasons for purchasing a home. Information in this brochure is subject to change. If you have any questions about the fairness of your loan, please contact one of the housing counseling agencies listed below to get a more personalized assessment of your situation.

Associated Catholic Charities
(901) 722-4700

Consumer Debt Counseling
(901) 276-2000

Financial Counselors of America
(901) 722-5000

LeMoyne-Owen College
Community Development Corporation
(901) 508-2823

Memphis Area Legal Services (MALS)
Memphis: (901) 432-4663
Covington: (901) 476-1808

Neighborhood Housing Opportunities, Inc.
(901) 729-2934

Orange Mound Community
Development Corporation
(901) 327-4205

The Works, Inc.
(901) 946-9675

United Housing, Inc.
(901) 272-1122

Vollintine-Evergreen Community Association
(901) 276-1782

Or you can call HUD at 1-800-569-4287
or visit their website at www.hud.gov

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Want to know if you are getting a good deal on a home loan?

Check the details!

A house is only a good deal if you pay the right price, get a fair loan, and can afford to live in the house for many years.

Your Home Loan Dictionary

Debt-to-Income ratio. How much money you owe for regular bills every month compared to how much money you make. Families who have a lot of debt compared to their income are at greater risk of losing their homes to foreclosure.

- 41% Debt/Income is preferred (41% of your income goes to bills, including your house note). 45% is the maximum.

- To figure, add your monthly bills (house note, insurance, taxes, car payments, other regular payments) and divide by your monthly before-tax income. For example:

  — If you make $20,000 a year, your gross income is $1,666 a month (before taxes), which gives you $683 a month to spend on debts (41%).

  — If you make $30,000 a year, your gross income is $2,500 a month (before taxes), which gives you $1,025 a month to spend on debts (41%).

- If you don't know your debt-to-income ratio, you might buy too much house. Just because a lender tells you that you can afford a $150,000 home doesn't mean you can easily make the monthly payments. The smartest choice is to buy a house that you can easily make the payments on. Wise buyers look at less expensive homes too.

Down payment. The money you pay up front in order to purchase a house. You can still buy a house without making a down payment, but that means you have no equity in the house. In other words, you won't own any of the house at the beginning.

- Put some money down on your house. We recommend a minimum of 1.5% of the total loan amount.

- Try to have one to two months' house payments in savings for repairs or other unplanned expenses.

Taxes and insurance. It's about $220 a month for a $100,000 house in the city of Memphis. This money is not paid on a monthly basis. It is paid in several big chunks. These big bills are often a problem for struggling homeowners.

- Have your monthly mortgage payment set up to include these payments. Each month that extra money will go into an escrow account. The bank will then use the money in

  your escrow account to pay the taxes and insurance for the year when they are due. If you are escrowing you will still get a tax bill — don't pay it.

Appraisals. They tell the borrower the current market value of a house so you don't pay more than it's worth. Appraisers are also used by banks to determind how much money should be loaned based on the appraised value of the house. Appraisal sheets should have a 12-month listing history that shows what the asking price for the house has been over the past year. **Be careful:** not all appraisals are accurate.

Home Inspections. They tell you what's wrong with the house, helping to prepare you for the things you will have to pay to have fixed when you move in.

- Always have an inspector look at the house you want to buy, even though the lender will not require it.

- A good inspector will give you a signed, multipage document that lists what is wrong with the house.

- Expect to pay between $150–$300 for this service.

- Many banks may require the seller to make repairs before closing, particularly on roofs, windows, HVAC, or other structural units.

Good Faith Estimate. An idea of what your closing costs will be and any other possible hidden costs in purchasing a home. The early Truth in Lending Disclosure, which will be given to you along with the Good Faith Estimate, gives you an idea of the interest rate you will pay.

- Get a ***signed*** Good Faith Estimate from your lender. Take it with you when you buy your house so that you can compare it to the actual costs being charged and avoid any of the possible problems listed in the following section.

Prepayment penalty. This is money you will pay if you pay off your loan early, or refinance your loan. Pre-payment penalties should be avoided if at all possible.

- If you can't avoid them, they should be no more than 3% of the total loan amount during the first year; 2% during the second; and 1% during the third.

Balloon payments. These loan types typically only last 5 to 7 years, during which you pay a relatively small monthly payment. At the end of the term, however, you must immediately pay a huge sum of money - the entire loan balance - or refinance with a new loan.

- Housing experts generally agree that low-and moderate-income home buyers should not purchase a house with a balloon note.