FTC FACTS for Consumers

Need a Loan?

Think Twice About Using Your Home as Collateral

If you need money to pay bills or make home improvements, and think the answer is in refinancing, a second mortgage, or a home equity loan, consider your options carefully. If you can't make the required payments, you could lose your home as well as the equity you've built up. That's why it's important not to let anyone talk you into using your home to borrow money you may not be able to afford to pay back.

Not all loans or lenders are created equal. Some unscrupulous lenders target older or low-income homeowners and those with credit problems. These lenders may offer loans based on the equity in your home, not on your ability to repay the loan. High interest rates and credit costs can make it very expensive to borrow money, even if you use your home as collateral.

Talk to an attorney, financial advisor, or someone else you trust before you make any decisions about borrowing money. Non-profit credit and housing counseling services also can be useful in helping you manage your credit and make smart decisions about loans.

Early Warning Signs

Avoid any lender who:

- tells you to falsify information on the loan application. For example, stay away from a lender who tells you to say that your income is higher than it is.
- pressures you into applying for a loan or applying for more money than you need.
- pressures you into accepting monthly payments you can't make or could have trouble making.
- fails to provide required loan disclosures or tells you not to read them.
- misrepresents the kind of credit you're getting, like calling a one-time loan a line of credit.
- promises one set of terms when you apply, and gives you another set of terms to sign — with no legitimate explanation for the change.
- tells you to sign blank forms — and says they'll fill in the blanks later.
- says you can't have copies of the documents that you've signed.

You can take some steps to protect your home and the equity you've built up in it. Here's how.

1. Shop Around. Costs can vary greatly.

Contact several lenders — including banks, savings and loans, credit unions, and mortgage companies. Ask each lender about the best loan you would qualify for. Compare:

- **The annual percentage rate (APR).** The APR is the single most important thing to compare when you shop for a loan. It takes into account not only the interest rate, but also points (one point equals one percent of the loan amount), mortgage broker fees, and certain other credit charges the lender requires the borrower to pay, expressed as a yearly rate. Generally, the lower the APR, the lower the cost of your loan. Ask if the APR is fixed or adjustable — that is, will it change? If so, how often and how much?
- **Points and fees.** Ask about points and other fees that you'll be charged. These charges may not be refundable if you refinance or pay off the loan early. And if you refinance, you may pay more points. Points usually are paid in cash at closing, but may be financed. If you finance the points, you'll have to pay additional interest, increasing the total cost of your loan.
- **The term of the loan.** How many years will you make payments on the loan? If you're getting a home equity loan that consolidates credit card debt and other shorter-term loans, remember that the new loan may require you to make payments for a longer time.
- **The monthly payment.** What's the amount? Will it stay the same or change? Find out if your monthly payment will include escrows for taxes and insurance.
- **Balloon payments.** This is a large payment usually at the end of the loan term, often after a series of lower monthly payments.

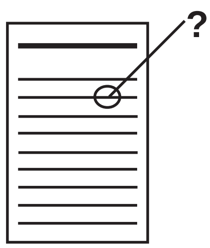
  When the balloon payment is due, you must come up with the money. If you can't, you may need another loan, which means new closing costs, as well as points and fees.
- **Prepayment penalties.** Prepayment penalties are extra fees that may be due if you pay off the loan early by refinancing or selling your home. These fees may force you to keep a high-rate loan by making it too expensive to get out of the loan. If your loan includes a prepayment penalty, understand the penalty you would have to pay. Ask the lender if you can get a loan without a prepayment penalty, and what that loan would cost. Then decide what's right for you.
- **Whether the interest rate for the loan will increase if you default.** An increased interest rate provision says that if you miss a payment or pay late, you may have to pay a higher interest rate for the rest of the loan term. Try to negotiate this provision out of your loan agreement.
- **Whether the loan includes charge for any type of voluntary credit insurance, like credit life, disability, or unemployment insurance.** Will the insurance premiums be financed as part of the loan? If so, you'll pay additional interest and points, further increasing the total cost of the loan. How much lower would your monthly loan payment be without the credit insurance? Will the insurance cover the length of your loan and the full loan amount? Before you decide to buy voluntary credit insurance from a lender, think about whether you really need the insurance and check with other insurance providers about their rates.

You'll also want to ask each lender to provide, as soon as possible, a written Good Faith Estimate that lists all charges and fees you must pay at closing. Ask for a Truth in Lending Disclosure, too. It states the monthly payment, the APR and other loan terms. Although lenders are not always required to provide these estimates, they're very helpful because they make it easier to compare terms from different lenders.

2. After Choosing a Lender

- **Negotiate.** It never hurts to ask if the lender will lower the APR, take out a charge you don't want to pay, or remove a loan term that you don't like.
- **Ask the lender for a blank copy of the form(s) you will sign at closing.** While they don't have to give you blank forms, most legitimate lenders will. Take the forms home and review them with someone you trust. Ask the lender about items you don't understand.
- **Ask the lender to give you copies of the actual documents** that you'll be asked to sign as soon as possible. While a lender may not be required to give you all of the actual filled-in documents before closing, it doesn't hurt to ask.
- **Be sure you can afford the loan.** Figure out whether your monthly income is enough to cover each monthly payment, in addition to your other monthly bills and expenses. If it isn't, you could lose your home — and your equity — through foreclosure or a forced sale.
- **If you are refinancing a first mortgage, ask about escrow services.** Ask if the loan's monthly payment includes an escrow amount for property taxes and homeowner's insurance. If not, be sure to budget for those amounts, too.

3. At Closing



- **Before you sign anything**, ask for an explanation of any dollar amount, term or condition that you don't understand.
- **Ask if any of the loan terms you were promised** before closing have changed. Don't sign a loan agreement if the terms differ from what you understood them to be. For example, a lender should not promise a specific APR and then — without good reason — increase it at closing. If the terms are different, negotiate for what you were promised. If you can't get it, be prepared to walk away and take your business elsewhere.
- **Before leaving the lender**, make sure you get a copy of the documents you signed. They contain important information about your rights and obligations.
- **Don't initial or sign anything** saying you're buying voluntary credit insurance unless you really want to buy it.

4. After Closing

Having second thoughts about the loan? **The Truth in Lending Act** gives most home equity borrowers at least three business days after closing to cancel the deal. This is known as your right of "rescission." In some situations (ask your attorney), you may have up to three years to cancel. To rescind, you must notify the creditor in writing. Make sure you document your rescission. Send your letter by certified mail, and request a return receipt. That will allow you to document what the creditor received and when. Keep copies of your correspondence and any enclosures. After you rescind, the lender has 20 days to return the money or property you paid to anyone as part of the credit transaction and release any security interest in your home. Remember that you must then offer to return the creditor's money or property, which may mean getting a new loan from another lender.

Where to Complain

If you think your lender has violated the law, you may wish to contact the lender or loan servicer to register your concerns. At the same time, you may want to contact an attorney,

High-Rate, High-Fee Loans

The Home Ownership and Equity Protection Act (HOEPA) may give you additional rights if your loan is a home equity loan, second mortgage or refinance secured by your principal residence and if:

- the loan's APR exceeds by more than 8 percent the rate on a Treasury note of comparable maturity on a first mortgage, or the loan's APR exceeds by more than 10 percent the rate on a Treasury note of comparable maturity on a second mortgage.
- the total fees and points at or before closing exceed $499 or 8 percent of the total loan amount, whichever is larger. (The $499 figure is for 2004 and is adjusted annually.) Credit insurance premiums written in connection with the loan count as fees for this purpose.

If HOEPA applies:

- A lender may not engage in a pattern or practice of lending based on home equity without regard to the borrower's ability to repay the loan.
- You must get certain disclosures from the lender at least three business days before closing.
- Your lender cannot make a direct payment to a home improvement contractor.
- Certain loan terms are illegal — such as most prepayment penalties and increased interest rates at default.
- In most situations, your loan cannot have a balloon payment due in less than five years.
- Due-on-demand clauses may not be used unless the consumer defaults.
- A lender that has made a HOEPA loan to a borrower generally may not refinance that loan into another HOEPA loan within the first year.
- Your lender may not call a one-time loan a line of credit.

A high-rate or high-fee loan might be right for you, but be aware that it has risks. It is an extremely expensive way to borrow money. You could lose your home if you can't make the payments.

your state Attorney General's office or banking regulatory agency, or the Federal Trade Commission. The FTC works for the consumer to prevent fraudulent, deceptive, and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them. To file a complaint or to get free information on consumer issues, visit www.ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. The FTC enters Internet, telemarketing, identity theft, and other fraud-related complaints into Consumer Sentinel, a secure online database available to hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

For More Information

The American Association of Retired Persons has information about predatory lending. You can access information by phone: toll-free 1-800-424-3410; by mail: AARP, 601 E Street, NW, Washington, DC 20049; or on the Web: www.aarp.org/consumerprotect-homeloans.

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1-877-FTC-HELP | www.ftc.gov

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