Banking: Loans

What are the advantages of prepaying a mortgage, and should I if I can?

It is highly recommended that you prepay as much of your mortgage as possible every month, which will drastically reduce the total amount that you pay. However, there are times where this could be disadvantageous. If you are in a situation where you don't have funds to cover three to six months of expenses, it is recommended that you save that amount before you pay additional amounts on your mortgage. If you have a large amount of credit card debt, over the long run, you will save more money by knocking down those high interest loans first. There also may be times where that money would be more wisely invested in the market, depending on the expected rate of return versus how much you would save in early payments.

Should I refinance?

In order to refinance your home, the current market rate should be at least 2 percentage points lower than what you are paying on your mortgage. Speak with a lender to see what rate you may be able to get. Remember to factor in costs like appraisals, points from the lender, and others, which may not be apparent in your initial price assessment. After assessing that cost, get a quote of what your total payment would be after refinancing. The simplest way to find out how long it will take to recover the refinancing costs will be to divide your closing costs by the monthly savings with your new monthly payment. Also take into consideration how long you plan on holding your home. It may not make sense to refinance the home if you plan on selling in the near future.

Does borrowing against my securities make sense?

This could be a low-cost option for borrowing but there is some risk involved. Deductions are not allowed for the interest unless that loan is used to invest in a business.

Can a Home Equity Line of Credit be beneficial?

A home equity line of credit is a form of credit which allows you to borrow and use your home as collateral. Since for many, a home is their greatest asset, they tend to use these sorts of credit lines for large things like a college education for their children, medical expenses or for large unexpected bills as opposed to luxuries or day to day expenses. After receiving a home equity line, one is approved for an amount of credit, or a maximum that may be borrowed at any given time for the duration of the plan. On many occasions a lender will set a credit limit on a home equity loan by setting a percentage, after considering the amount of the appraised value of the home and the amount owed on the home. After the line of credit is approved, you will be able to borrow up to the set limit, usually in the form of checks. In some instances a borrower may be given credit cards to utilize, sometimes with minimum spending requirements.

What costs are associated?

- The costs associated with getting a home equity loan are basically the same as a refinance.
- Appraisal
- A non-refundable application fee
- Up front points, which equal one percent of the entire credit limit
- Closing costs, which are the same as the closing costs you would pay upon purchasing a home
- Yearly fees and the possibility of a transaction fee per draw

How can you lock in an interest rate?

After choosing a lender, you may be quoted a rate, which may "float" until the actual closing, meaning that it is not guaranteed. With a lock-in you are guaranteed that the interest rate will not change before your closing. You may want to ask for an agreement that ensures that your rate is capped but allows you to take advantage of a lower rate if the rate lowers before you close. There is usually a time limit that a lender will put on this guarantee, and if you don't close before that time, they no longer have to honor that lock-in. It is recommended that you stay in close contact with your loan officer during the process to ensure that you are able to close in a timely manner and get the locked-in rate.

What disclosures should I get from my lender?

The lender is obligated by the Truth in Lending Act to provide you with a written statement with a list of all of the costs associated with the loan and the terms of financing. This statement must be delivered to you before the settlement. If you want to rescind the loan, you may do so within 3 business days of the receipt of the Truth in Lending paperwork, receipt of cancellation notice, or your settlement, whichever was the most recent. You will want to carefully review the disclosure that you are given before you sign. This disclosure will have all of the pertinent information about your loan, the finance charge, the amount financed, the payment schedule and the APR.

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How does a reverse mortgage work?

A reverse mortgage is a way for you to take advantage of some of the equity that is currently tied up in your home. A reverse mortgage works in the same manner as a normal one but reversed where the homeowner is paid monthly versus having to pay. The major difference between this and a home equity loan is that you aren't required to pay anything back to the lender as long as you retain ownership of the home. The major benefit of a reverse mortgage is that it allows homeowners to take advantage of some of the equity that they have built up in their homes without the burden of having to pay it back in monthly payments. This could be used to supplement income, defray the cost of medical aid, pay for college education, stop a foreclosure or to make it possible to retire. When the homeowner sells the home or dies, the home must be paid off and, if sold, the remainder of equity is given to its rightful heirs.

Is any loan interest tax deductible? These interests are deductible, some fully, some partially:

- Education-related interest
- Business interest
- Investment interest
- Mortgage interest

Can you stop paying Private Mortgage Insurance (PMI)? Usually people that make a down payment of less than 20% are required to pay private mortgage insurance by their lender. Once you reach 20% equity, PMI is cancelled, and any money accrued in your escrow account towards it will be credited to you.

What are the possible implications if I co-sign for a loan?

The co-signer enters an agreement to be responsible for the repayment of the loan if the borrower defaults. A lender will usually not go after the co-signer until the borrower defaults, but they can lawfully go after the co-signer at any time. It has been stated by finance companies that in the case of a default, most co-signers actually pay off the loans that they have co-signed for including the legal and late fees that end up being tacked on. Clearly this can be a large financial burden, and it can also reflect negatively on the co-signer's credit. If you do agree to co-sign on a loan for someone, you can request that the financial institution agrees that it will refrain from collecting from you unless the primary borrower defaults. Also, make sure that your liability is limited to the unpaid principal and not any late or legal fees. Upon co-signing you may have to brandish financial documents to the lender just as the primary borrower would have to. Co-signing for a loan gives you the same legal responsibility for the repayment of the debt as the borrower. If there are late payments, this will affect your credit as well. If you are asked to co-sign for someone, you may want to provide another option and suggest that they get a secured credit card. This way, they can build up their own credit history and not open themselves up to the possibility of taking on a debt too large and placing themselves and you in financial danger.

How can I ensure that I get the best possible rates on my loans?

Be careful when signing up for a home equity loan or line of credit; the disclosed APR does not reflect the total fees that are associated with the loan, such as closing costs and others. Do not forget to compare this cost, as well as the APR, across multiple lenders. The vast majority of home equity plans will utilize variable interest rates instead of fixed. A variable rate reflects the current prices of a publically available index (like the prime rate or the U.S. Treasury Bill rate), and the rate of your loan will oscillate accordingly. Generally a lender will offer a discounted introductory rate, often referred to as a "teaser rate." Take caution - these rates can sometimes fluctuate unless it is stated that there is a fixed rate. Sometimes the lender will give you a great introductory rate that is variable and can change with time to a rate much higher than you originally agreed to. Since the rate is linked to an index rate, find out which one it is and how much their margin is. Some companies will have a cap on how much your rate can vary within a particular period of time.

Is it better to get a home equity line of credit or a traditional second mortgage?

With a second mortgage you will have a fixed amount of money that is repayable over a fixed period of time, or it is due in full at a given time. A home equity line of credit, on the other hand, is much more open-ended. You have a line of credit that can be borrowed from as you wish, and generally it has a variable rate as opposed to a fixed rate. Pay attention to the fact then when the APR is calculated it takes into account the interest rate charged plus points, finance charges and other fees, whereas with a home equity line the APR is calculated with solely the periodic interest rate.

What will the loan cost?

Before you are charged any fees, the Truth in Lending Act requires that the lenders disclose to you all pertinent terms of the agreement: the APR, payment terms, other charges, and any information about variable interest. Generally you will receive these disclosures at the same time that you receive an application form and any additional disclosures promptly after. If any of the terms change prior to the loan closing, the lender must return all fees that have been applied should you choose to back out of the deal. The finance charge is the total amount paid in exchange for the use of credit, which includes the interest rate, service charges and insurance premiums. The Annual Percentage Rate (APR) is the percentage paid on a yearly basis.

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