There are a number of ways in which you can be tempted to use your equity in your home to obtain new loans to help pay off old debt:

- **Taking out a second mortgage on your home.** You then have to make monthly payments both on your first and your second mortgage, and you can lose your home if you fail to make payments on either loan.
- **Taking out a home equity line of credit.** When you need cash, you draw on your line of credit, up to a set amount. You must make minimum payments each month and risk losing your home if you do not make those payments.
- **Refinancing your existing mortgage loan with a higher principal balance, either with your existing or a different lender.** If this increases your monthly payment, this also increases your risk of foreclosure.
- **Borrowing through a reverse mortgage.** Because of its complexity, this option is described in its own chapter, Chapter 6 [1].

Borrowing against your home is risky, but might make sense in the right circumstances and with the right loan. Home mortgages tend to have lower interest rates and more years to repay than other types of loans. Drawing on your home equity may make sense if your financial situation is pressing. If you can refinance your existing mortgage with a new loan that reduces your net borrowing costs, you might even be able to borrow additional cash while not increasing your monthly payments.

On the other hand, even though interest rates may be relatively low, closing costs, points, fees, and the like may mean that your initial outlay on your mortgage loan will be quite expensive, and be a bad idea, particularly if you are soon going to sell your home (or lose it to foreclosure).

Taking out a new loan secured by your home also puts your home at risk for foreclosure. If you are in danger of losing your car, you may be tempted to pay off your car loan by taking out a second mortgage on your home. You may save your car temporarily this way, but you are putting your home in danger.

**Avoiding the Wrong Mortgage Loans.** Avoid predatory lenders that hide from you the true cost of their high cost mortgage loans. Be wary of anyone who initiates contact with you about a mortgage loan, particularly if the solicitation does not come from an established financial institution in your community. Definitely avoid anyone who solicits loans during a “door-to-door” visit of your home. It is very expensive to market anything door to door. The odds are that someone coming to the house to help bail you out of trouble will really get you deeper into it.

Another way to avoid scams is never to let a contractor or sales person arrange financing for you and to be wary of mortgage brokers. Some brokers will find loans for you which involve big commissions for them rather than good loans for you. If your regular banker or credit union cannot help you, odds are that lenders and brokers who advertise cannot get you a good deal either. Be wary also of a lender who claims that you will get a tax advantage from a mortgage loan. Most consumers will not be able to deduct their mortgage interest, particularly if it is a second mortgage.

When in doubt, check out the lender with your state’s attorney general, banking commission, or consumer complaint hotline. Check both the business name and the names of any individual you are dealing with because some individuals change their company names repeatedly to avoid becoming well-known in the community. If you do check on a business, remember that the absence of complaints does not necessarily mean that the business is reputable.

**Read and Understand the Mortgage Terms.** Your lender should give you a closing disclosure with the final terms and charges. Read it carefully to see if it is consistent with what the lender promised you. You can always walk away before signing loan papers, even at the last minute. Definitely walk away if the lender tries to change the loan terms or costs from what you had originally discussed. Also be wary of a lender who refuses to put in writing any oral promises upon which you are relying.

Never sign documents without knowing what is in them. When in doubt, get help in reviewing the loan papers before you sign anything. A lender that is unwilling to let you get outside help before you sign the loan documents should not be trusted. You might contact a HUD-certified housing counselor for advice on the loan terms. You can find such a counselor by calling HUD at 800-569-4287 (TDD 800-877-8339) or by going to www.hud.gov [2].

Walk away from a bad deal even at the last minute. If loan terms are not favorable, shop around for another loan. Within three business days after receiving your loan application, the lender or mortgage broker must provide you with a loan estimate of closing costs. You should use this form to compare loans from different lenders. You can also negotiate with the lender by...
A mortgage loan can involve great potential for hidden costs, fees, and other unfair loan terms. Even some reputable lenders make unfair loans. When you take out a home mortgage loan, you often have to pay points (one point equals 1% of the loan amount; for example, 1% of $100,000 equal $1,000), closing costs, a broker’s fee, or other up front charges. Closing costs may include title services, the preparation of closing documents, obtaining credit reports and appraisals, property surveys, inspections, loan processing, and other similar charges. All of these fees provide lenders with an opportunity to take advantage of unwary borrowers by including excessive, duplicative, or unearned fees. The best way to avoid being ripped off is to shop around. By comparing the fees from different lenders, you’ll be able to weed out those trying to charge excessive fees.

On the other hand, do not expect to get the best mortgage loan rates if you have a blemished credit score. If your credit score is under 670, most lenders will consider you to be a riskier borrower and will probably charge you more. Shop around even if your credit score is low. Do not assume that the deal offered by a particular lender is the best you can do. Up to one-third of all borrowers that end up with higher cost loans actually qualified for lower cost products.

Charges for Insurance. Watch out for unnecessary insurance added on to the mortgage. An example is credit-life and credit-accident and health insurance or similar products called “debt cancellation” or “suspension” contracts. These policies or contracts are supposed to pay off your loan or suspend your payments for a period of time if certain conditions occur, such as you are in an accident. Typically, you will be asked to initial a statement that you want this coverage. You should not do so. Only a small percentage of these insurance premiums or charges are ever paid out as losses to policyholders.

These policies or contracts also are often designed so that companies can deny coverage to you even when it appears that you have a valid claim. For example, the insurance may not cover many types of accidents that you would expect it to cover. Any benefits that are paid out are limited to the amount left on the loan, so you never actually receive much, if anything. You will be better off buying insurance from other sources.

When Refinancing, Are You Saving Money or Throwing It Away? You may be tempted to obtain a new mortgage loan that pays off your old mortgage and other debts as well. One question is whether—when taking all costs and charges into consideration—you are paying more on the new loan than you were paying on the old ones. This is important not just because it is a bad deal, but also because if you could not make payments on your old debts, how can you avoid foreclosure by consistently paying on a refinanced loan that is more expensive than what you were paying before?

It is not simply comparing the cost of your old mortgage and other debt with the cost of a new mortgage that refinances the old debt. Compare the stated interest rates you are paying under the old and new loans. And then it gets more complicated. Your new loan will likely include closing costs, title insurance, points, fees, and other charges that must be considered. These might have been included under your old loan as well, but you have already paid for those. The question is how much more will you be paying now that you have to pay all those fees and charges all over again for the new loan. The paperwork you get with the new loan will set out all the fees and charges and some of these will be included in the “Annual Percentage Rate” or “APR” disclosed on the new loan. Is this higher than the stated interest rates on the old loans?

Next you have to consider any prepayment penalties for paying off the old loan early. These penalties are an added cost of the new loan. You also have to consider whether your old loan was at a fixed rate and your new loan at a variable rate (or vice versa). Fixed rate loans are safer because variable rate loans can suddenly increase your monthly payment. In addition, some variable rate loans are set up so that they will almost always increase the interest rate shortly after you take on the loan.

Another question to ask is whether you have taken on added risk with a refinanced home mortgage, because your monthly carrying costs secured by your home go up, and thus put you at risk of foreclosure. This is a bad idea if your increased payments on the refinanced loan (and increased risk of foreclosure) are caused by it paying off medical bills or credit card debt that are relatively low priority loans.

When You Change Your Mind About Taking Out a New Mortgage Loan. You can always back out of a mortgage loan you have already paid for those. The question is how much more you will have to pay. It is not simply comparing the cost of your old mortgage and other debt with the cost of a new mortgage that refinances the old debt. Compare the stated interest rates you are paying under the old and new loans. And then it gets more complicated. Your new loan will likely include closing costs, title insurance, points, fees, and other charges that must be considered. These might have been included under your old loan as well, but you have already paid for those. The question is how much more will you be paying now that you have to pay all those fees and charges all over again for the new loan. The paperwork you get with the new loan will set out all the fees and charges and some of these will be included in the “Annual Percentage Rate” or “APR” disclosed on the new loan. Is this higher than the stated interest rates on the old loans?

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