

Read the Fine Print to Make Sure you're not Living in House of Cards

by Lynn O'Shaughnessy

One of the rituals of buying a house or refinancing a mortgage is signing a stack of paperwork. The time it takes to slog through these documents can seem interminable, but can you imagine how time-consuming the process would be if you actually read the stuff you were signing? My husband and I are as guilty as probably the rest of you. In the past, when a notary has shoved papers across our dining room table, we've pretty much been focused on making sure we signed and initialed everything. We have always relied upon the efficient paper pusher to supply us with pens and a blur of an explanation about each document. We could have been initialing clemency papers or signing away the rights to our home with an iffy roof, a balky garden and a bathroom with orange tiles that my husband loathes. I have always felt vaguely uneasy about blowing off our responsibility. And yet, nothing bad has ever seemed to happen when we've refinanced to capture lower interest rates. We haven't encountered any problems as we've chipped away at our current 15-year fixed-rate mortgage. So what's the harm? Actually, our inattention could be costing us an obscene amount of money. If you daydream through the loan process - from the first conversation with a lender or mortgage broker to the last signature - you may end up paying far more over the course of your mortgage than you could imagine. When homeowners are distracted, it's amazing the sort of booby traps that can remain undetected within 50 cents worth of legal-sized paper. Whether you're refinancing or obtaining a new loan, what's critically important is understanding what the loan's costs are and, even more basic, what type of loan it is. If you don't remain alert, you could get skewered, breaded and deep-fried by a master chef of the double cross. That's what happened to one unfortunate borrower in San Diego, who was quite adamant when he told a mortgage broker what he desired. The man wanted the lowest monthly payments possible on a \$400,000 loan because he intended to flip the house and pay off the mortgage within a year. Months after the paperwork was processed, he discovered that his loan had fangs. His broker had hooked him up with a negatively amortized loan that would charge 3 percent of the loan's value as a penalty if he abandoned it before 36 months had expired. It was only after the borrower sought help from John M. Smith, a mortgage broker at Old Mission Mortgage in San Diego, that he learned that the original guy had collected a \$16,000 commission. The client had directly paid him a point, or 1 percent, of the loan amount, but he didn't realize that the bank had paid the broker another 3 percent. The compensation, Smith observed, was "egregious and beyond the pale." If our homeowner had known the bank was rewarding the broker with such a princely fee, he might have wondered why the financial institution was so jubilant about sealing this deal. Actually, the bank was thrilled the broker had found a sucker who didn't notice the loan's stench. The borrower's experience provides an excellent lesson to remember. If the lender is willing to pay all the costs, otherwise known as a no-cost loan, your interest rate will be higher and the loan term won't be as good. You can also expect a greater interest rate if you pay a modest amount toward the closing. If you don't plan to stay in a home for many years, sometimes you might want the lender to pick up the points. Other times, however, you may want to shoulder the costs to obtain the loan with the most appealing interest rate. What's important is that a mortgage broker should explain all the options and how he or she will get paid so customers can make informed decisions. If you intend to rely on a mortgage broker, you should look for one who will disclose all the fees upfront in plain English. To get the broker aligned with you, you should ideally find one who will charge you a fee for finding you a loan. Because you are picking up the tab, which is usually 1 percent of the loan's value, the broker will look for the best wholesale loan. The average wholesale loan typically offers an interest rate that is three-eighths of a percent lower than the retail version, says Jack M. Guttentag, a professor of finance emeritus at the University of Pennsylvania's Wharton School and the founder of Mortgage Professor (www.mtgprofessor.com). If you pay the points and get a lower interest rate in return, Smith says you will usually benefit financially if you keep the loan for at least five years. Ultimately, how do you know what you're paying? A broker's compensation must be disclosed in something called the "initial good faith estimate" at the start of the loan process. It will show up again in the closing statement. The fee is typically called a "loan origination" or "mortgage broker fee." If you aren't being hit with a loan origination fee, that means the lender is picking up the tab. The bank's payment to the broker will appear as the "yield spread premium." A knowledgeable mortgage broker can be invaluable when buying a home. You don't want to be e-mailing an Internet lender about why your loan has not been funded when your moving van is in the driveway. Some people will find it

more reassuring to be able to contact an individual they've met. When refinancing, usually the stakes are not so high, so you may not need a broker. If you feel comfortable shopping online, you can look for your own deals. Finding mortgage quotes online is preferable to calling lenders or looking in newspapers, Guttentag insists. "If your loan is priced on a Web site," he says, "it will be easy to find and to compare the quote on other sites." In contrast, he says, "telephone and e-mail quotes by brokers and loan officers cannot be relied on unless the borrower knows the source and has good reason to believe it's trustworthy." To learn much more about obtaining the best mortgages, you should explore Guttentag's site, which includes his rankings of online lenders. If you spend as much time on the loan process as you have speculating on who will win the NBA finals or whether Oprah is gaining weight, you will undoubtedly save yourself money. Copley News Service

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