



## Looking for a Mortgage?

### Tips for Safe Borrowing

Predatory lenders use a number of tactics to trick homeowners into loans with unjustifiably high interest rates and other costs. The monthly payments on these loans are often so high that homeowners end up losing their homes. This short list of tips is designed to help you avoid getting trapped in a predatory loan. The list is by no means complete. To fully protect yourself from a predatory loan, you should have an attorney go over all loan documents before you sign them. Do not let a lender pressure you into signing anything before you have some time to think it over. If you cannot afford an attorney, you should bring your loan documents to a HUD-approved housing counseling agency. A list of Illinois agencies is available at [www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm](http://www.hud.gov/offices/hsg/sfh/hcc/hccprof14.cfm) or by calling 1-800-569-4287.

**Affordability:** Make sure you earn enough income to meet your monthly mortgage payment. The majority of *legitimate* lenders use a simple 28/36-ratio test to figure out the mortgage you qualify for. You should use it, too. The test has two parts. To pass the first part, the sum of your monthly mortgage payment, homeowner's insurance, and property taxes should not be more than 28 percent of your monthly gross income. To pass the second part, your monthly debts, *including your mortgage payment*, should not be more than 36 percent of your monthly income. If you fail either part of this test, chances are you will have a very tough time making your monthly mortgage payments.

**Adjustable-Rate Mortgages (ARMs) vs. Fixed-Rate Mortgages:** A legitimate ARM is an adjustable-rate mortgage whose interest rate can *go up or down* during the life of the loan. Predatory lenders, however, often use ARMs whose interest rates *only go up* during the life of the loan. This kind of ARM allows lenders to lure you into a loan with an attractively low "teaser" rate and then ratchet up the payment as often as every six months. For most homeowners, a fixed-rate mortgage, where the interest rate is locked in for the life of the loan, is the better choice.

**Balloon Payments:** Beware of mortgages containing balloon payments! A balloon payment is an extremely large payment that usually follows a series of low monthly payments. If you cannot make a balloon payment when it comes due, either you will lose your home or you will be forced to pay additional high costs and fees to refinance the loan.

**Excessive Prepayment Penalties:** Predatory mortgage loans typically charge huge penalty fees if you pay off the loan early or refinance it with a cheaper loan. Watch out for these. Prepayment penalties are designed to keep borrowers trapped in high-cost loans.

**Good Faith Estimate (GFE):** A lender must provide you with a Good Faith Estimate, or "GFE," within three days of receiving your loan application. Look at the GFE carefully—it closely reflects what your monthly payments will be, no matter what the lender verbally tells you. A lender who tells you to ignore the GFE is lying to you.

**Interest-Only Loan:** An interest-only loan is structured so that the borrower pays only interest on the loan for the first few years. During the interest-only period, none of the monthly payment goes toward principal. This means that the monthly payment during the interest-only period of the loan is much lower than it would be if an additional portion of the monthly payment were going to pay down the principal. The downside of these low payments is that the borrower builds no equity in the home, and the amount

owed on the loan is the same at the end of the no-equity period as it was on the first day of the loan. Consequently, when the term of the loan is over, the borrower must either pay off the full amount of the loan in a balloon payment or make much larger payments to pay off the loan by the end of the loan term.

**Misstated Income:** To make it look as if you can afford your mortgage payments, a predatory lender might try to persuade or trick you into stating on paper that you earn more than you really do. Never sign a loan document that does not accurately state your income.