FTC Consumer Alert

Federal Trade Commission • Bureau of Consumer Protection • Office of Consumer and Business Education

Need a Loan?

Think Twice About Using Your Home as Collateral

If you need money to pay bills or make home improvements, and think refinancing, a second mortgage, or a home equity loan is the answer — 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. Don't let anyone talk you into using your home to borrow money you don't really need.

Not all loans or lenders are created equal. Some unscrupulous lenders target elderly and 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 borrowing money using your home very expensive.

Consult with your attorney, financial advisor, or someone else you trust before making any loan decisions. Non-profit credit and housing counseling services can also be useful in helping you manage your credit and make decisions about loans.

Early Warning Signs

Avoid any lender who:

- tells you, or requires you, to falsify information on the loan application. For example, the lender tells you to say that your loan is primarily for business purposes when it's not.
- 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.
- fails to provide required loan disclosures or tells you not to read them.
- misrepresents the kind of credit you're getting. For example, 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 — the lender says they'll fill them in later.
- says you can't have copies of documents that you've signed.

You can take some steps to protect your home and your equity. 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 for which you qualify. Compare:

- **The annual percentage rate (APR).** The APR is the single most important thing to compare when shopping 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 the APR change?
- **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 are usually paid in cash at closing, but may be financed. If you finance the points, you'll pay additional interest and increase 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 period.
- **The monthly payment.** What's the amount? Will it stay the same or change?
- **Is there a balloon payment?** This is a large payment usually at the end of the loan term, often after a series of low 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, and points and fees.

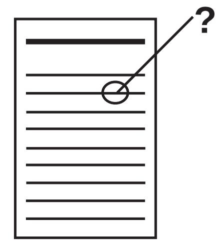
- **Is there a prepayment penalty?** These are extra fees that may be due if you pay off the loan early by refinancing or selling your home. Prepayment penalties may force you to keep a high-rate loan by making getting out of the loan too expensive. Try to negotiate this penalty out of your loan agreement.
- **Will the interest rate for the loan 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 as well.
- **Does the loan include a charge for any type of voluntary credit insurance, such as 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 and further increase the total cost of the loan. How much lower would your monthly payment on your loan be without the credit insurance? Will the insurance cover the length of your loan and the full loan amount? Before deciding 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.

Lastly, 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. Although not always required, these estimates 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'll 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 have 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 homeowners 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 thought they would 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, be prepared to walk away and shop elsewhere.
- Make sure you get a copy of the documents you signed before leaving the lender. 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 that insurance.

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 (consult with your attorney), you may have as much as three years to cancel. To rescind, you must notify the creditor in writing. After you rescind, the lender has 20 days to return all money or property you paid to anyone as part of the credit transaction and release any security interest in your home. 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 or you want information about a right to rescind, contact a private attorney, your state's 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.

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% the rate on a Treasury note of comparable maturity on a first mortgage, or the loan's APR exceeds by more than 10% the rate on a Treasury note of comparable maturity on a second mortgage.
- the total fees and points at or before closing exceed the larger of $488 or 8% of the total loan amount. (The $488 figure is for 2003 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 of the risks. These loans are extremely expensive ways to get money. You could lose your home if you can't make the payments.

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/getans/predatorylending.html.

FEDERAL TRADE COMMISSION	FOR THE CONSUMER
1-877-FTC-HELP	www.ftc.gov

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