Using Your Home as Collateral

If you need money to pay bills or make home improvements, and think the answer is in refinancing, a second mortgage, or a home equity loan, consider your options carefully. If you can't make the payments, you could lose your home as well as the equity you've built up. Talk to an attorney, financial advisor, or someone else you trust before you make any decisions about borrowing money using your home as collateral.

Early Warning Signs

Don't let anyone talk you into using your home as collateral to borrow money you may not be able to pay back. High interest rates and credit costs can make it very expensive to borrow money, even if you use your home as collateral. Not all loans or lenders (known as "creditors") are created equal. Some unscrupulous creditors target older or low income homeowners and people with credit problems. These creditors may offer loans based on the equity in your home, not on your ability to repay the loan.

Avoid any creditor who:

- tells you to lie on the loan application. For example, stay away from a lender who tells you to say that your income is higher than it is.
- pressures you into applying for a loan or for more money than you need.
- pressures you into accepting monthly payments you can't comfortably make.
- doesn't give you required loan disclosures or tells you not to read them.
- misrepresents the kind of credit you're getting, like 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 and says they'll fill in the blanks later.
- says you can't have copies of documents you signed.

Protecting Your Home and Equity

Here are some steps you can take to protect your home and the equity you've built up in it when you are looking for a loan.

<u>Shop Around.</u>

Costs can vary greatly. Contact several creditors, including banks, savings and loans, credit unions, and mortgage companies. Ask each creditor about the best loan you would qualify for. Compare:

- **The annual percentage rate (APR)**. The APR is the single most important thing to compare when you shop for a loan. It takes into account not only the interest rate(s), but also points (each point is a fee equal to one percent of the loan amount), mortgage broker fees, and certain other credit charges you have to pay the creditor, 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 it change? If so, how often and how much?

- **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 usually are paid in cash at closing but may be financed. If you finance the points, you'll have to pay additional interest, which increases 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, you may have to make payments on those other debts for a longer time.
- **The monthly payment**. What's the amount and will it stay the same or change and will your monthly payment include escrows for taxes and insurance or will you have to pay for those items separately?
- **Balloon payments**. This is a large payment usually due at the end of the loan term, often after a series of lower 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, points, and fees.
- **Prepayment penalties**. These are extra fees that may be due if you pay off the loan early by refinancing or selling your home. These fees may force you to keep a high rate loan by making it too expensive to get out of the loan. If your loan includes a prepayment penalty, find out what you would have to pay. Ask the creditor if you can get a loan without a prepayment penalty, and what that loan would cost.
- **Whether the interest rate for the loan will 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.
- **Whether the loan includes charges for any type of voluntary credit insurance, like 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, further increasing the total cost of the loan. How much lower would your monthly loan payment be without the credit insurance? Will the insurance cover the length of your loan and the full loan amount? Before you decide to buy voluntary credit insurance from a creditor, think about whether you really need the insurance and comparison shop with other insurance providers for their rates.

Generally, the creditor or mortgage broker will give you a written Good Faith Estimate that lists charges and fees you must pay at closing, and the creditor will give you a Truth in Lending Disclosure that lists the monthly payment, the APR, and other loan terms. If you don't get these, ask for them. That makes it easier to compare terms from different creditors.

<u>Once You’ve Chosen a Creditor</u>

Negotiate. It never hurts to ask if the creditor 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 creditor for a blank copy of the form(s) you will sign at closing. While they don’t have to give them to you, most honest creditors will. Take the forms home and review them with someone you trust. Ask the creditor about items you don’t understand.

Ask the creditor to give you copies of the actual documents that you’ll be asked to sign. The creditor may not have to give you all of the actual filled in documents before closing.

Be sure you can afford the loan. Do the math. 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're refinancing the original mortgage on the property, ask about escrow services. Does the loan's monthly payment include an escrow amount for property taxes and homeowner's insurance? If not, be sure to budget for those amounts, too.

At Closing

Before you sign, get an explanation of 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 understood. A creditor 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 get it, be prepared to walk away and take your business elsewhere.
Before leaving the creditor, make sure you get a copy of all the documents you signed. 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 it.

After Closing

Most home equity borrowers have at least three business days after closing to cancel the deal. This is known as your right of "rescission." In some situations, you may have up to three years to cancel. To cancel the loan, you have to tell the creditor in writing. Send your letter by certified mail and ask for a return receipt. That will allow you to document what the creditor received and when. Keep copies of your correspondence and any enclosures. After you cancel, the creditor has 20 days to return the money or property you paid to anyone as part of the credit transaction and release any security interest in your home. Then, you have to offer to return the creditor's money or property, which may mean getting a new loan from another creditor.

High-Rate, High-Fee Loans

You may have additional rights under the Home Ownership and Equity Protection Act if your loan is a home equity loan, second mortgage, or refinance secured by your principal residence and if**:**

- the loan's APR is more than 8 percentage points higher than the rate on a Treasury note of comparable maturity on a first mortgage, or the loan's APR is more than 10 percentage points higher than the rate on a Treasury note of comparable maturity on a second mortgage.
- the total fees and points at or before closing exceed $1,000 or 8 percent of the total loan amount, whichever is larger. (The $1,000 figure is for 2020; the amount is adjusted annually.) Credit insurance premiums written in connection with the loan count as fees in this situation.

Higher-Priced Loans

You may have additional rights if your loan is used to buy a home, a home equity loan, a second mortgage, or a refinance secured by your principal residence and the Annual Percentage Rate is above the average prime offer rate for a comparable transaction on the date the interest rate is set.

Getting Legal Help

If you feel you cannot afford an attorney, free legal assistance may be available by contacting: Acadiana Legal Service Corporation at (337) 237-4320 or by visiting www.la-law.org for more information or to find out if you qualify.