

If You Read Only One Chapter, Read This One

The Problem

In my fantasy world, everyone could be trusted to take care of their customers and do what was in the customer's best interests, whether it benefitted the service provider directly or not. Then I woke up and remembered I live here on Planet Earth.

Remember, things are not always as they appear...

MONTANA STATE TROOPER

In most of the United States there is a policy of checking on any stalled vehicle on the highway when temperatures drop to single digits or below. About 3 AM one very cold morning, Montana State Trooper Allan Nixon #658 responded to a call there was a car off the shoulder of the road outside Great Falls, Montana. He located the car, stuck in deep snow and with the engine still running. Pulling in behind the car with his emergency lights on, the trooper walked to the driver's door to find an older man passed out behind the wheel with a nearly empty vodka bottle on the seat beside him. The driver came awake when the trooper tapped on the window. Seeing the rotating lights in his rearview mirror, and the state trooper standing next to his car, the man panicked. He jerked the gear-shift into 'drive' and hit the gas.

The car's speedometer was showing 20-30-40 and then 50 MPH, but it was still stuck in the snow, wheels spinning. Trooper Nixon, having a sense of humor, began running in place next to the speeding (but stationary) car. The driver was totally freaked, thinking the trooper was actually keeping up with him. This goes on for about 30 seconds, then the trooper yelled, "PULL OVER!"

The man nodded, turned his wheel and stopped the engine. Needless to say, the man from North Dakota was arrested and is probably still shaking his head over the state trooper in Montana who could run 50 miles per hour.

Who says troopers don't have a sense of humor?

In the real world, some people are trustworthy and others are not. How do you tell the difference and protect yourself from the untrustworthy ones?

The Solution

This book teaches you enough about the mortgage industry to dispel confusion and help you negotiate a good, fair home loan.

This Chapter includes:

- 🏡 The most common ways lenders and closing agents cheat borrowers.
- 🏡 How to prevent abuse, in most cases.
- 🏡 How to read loan documents so that you know that you are getting the loan you were promised.
- 🏡 A brief synopsis of the other chapters in this book, to help you decide which ones to read.

Protection from Unscrupulous Bankers and Brokers

Here are the most common ways lenders cheated borrowers in the past. Recent legislation eliminates the opportunity to inflict some of these abuses on borrowers. However, in my experience, false advertising is still alive and well.

- ✓ Quote one rate, while another shows up in the loan docs;
- ✓ Obscure the fact that the loan is an adjustable rate loan, making you think you are getting a rate that is fixed for the entire term of the loan;
- ✓ Obscure the fact that the loan has the potential for negative amortization (Note: few negative amortization loans exist in the market, as of late 2009. So this is rarely an issue currently, but it has been a big issue in the past and may become one again in the future.);
- ✓ Add junk fees that appear legitimate.
- ✓ Sell the loan to you as a “no points” loan, while not revealing that there are fees which are equal to, or greater than the amount an honest lender would charge in points. If you have the choice between paying fees or points, choose points. Points are tax deductible, fees are not (please consult your tax preparer for specifics).

The simplest way to protect yourself from these practices is to download an agreement form I created to clarify the loan you are being offered. Present this form to the lender, ask him to complete and sign it.

My intention, when I created the form, was to provide you with a tool that will both clarify the terms of any loans proposed to you, and discourage would-be con men from victimizing you. My greater hope is that this form of protection will become so widely used that the dishonest lenders will leave the mortgage industry altogether. However, I tend to be an optimist; sometimes unrealistically so. Realistically, you need to learn how to protect yourself.

This form is free to readers of this book. There is a copy at the back of the book, or if you want to download it, go to: www.HollyHomeLoans.com and you'll find "Lender Loan and Fee Agreement" on the "Consumer Protection" tab.

I would like to point out that within the last year and a half, more and more lenders are requiring brokers to present the borrowers with a form similar to the one provided with this book upon loan submission. Their form spells out costs and rebate to the broker, but rarely clarifies loan terms; and does not offer rate and point options, as my form does. If your broker offers you a form from the bank you are submitting your loan application to that is clear and specific about all fees, you may not need your broker to complete mine. Additionally, the RESPA regulations of January 1, 2010 require that a great deal more information be disclosed about the loans than previous forms provided. I discuss this in greater depth in the chapter on Junk Fees.

Protection from Escrow Junk Fees

I work in California, which is an escrow state. I do very few loans in attorney states. At this point, I am only qualified to speak about the junk fee practices I have encountered in escrow. However, my friends in attorney states tell me that the same practices go on in those states. For the purposes of this book, the term "escrow" is defined as the closing agent, whether that agent is an escrow officer or an attorney.

I see escrow companies make up ridiculous junk fees all the time, but only in purchase transactions. The reason junk fees usually do not show up as often when you refinance is that your loan officer chooses the escrow company for refinances. The listing agent usually chooses the escrow for purchases. My escrow company would never cheat my client, because they are as honest as I am. I hope the same will be true for the escrow company your loan officer chooses.

If I could change one thing about purchase transactions, it would be that the buyer's agent or loan officer should be able to choose the escrow company. The buyers are impacted the most, from a fee standpoint, by the escrow company. However, because this isn't the case at the present time, I created a form, much like the lender protection form discussed above, that clarifies escrow fees up front.

It is important to deal with escrow fees **in the beginning**, when you have the most leverage; because all of the players want your business. If you wait until the end of the transaction, you may not be able to get the junk fees waived, because you may be too far along in the process to back out if the fees are not waived. This form is on the same page, online, as the

lender fee form. Additionally, the RESPA regulations of January 1st 2010 require that a great deal more information be disclosed about the loans than previous forms provided.

Choosing the Right Loan Officer

Your best protection from lender abuse is to choose an honest loan officer up front. Many people make the mistake of thinking that a loan officer who works for a bank would be more honest than a broker. However, my experience is that there are dishonest people in both the banking and brokering communities. There is an entire chapter on that subject alone. Briefly, you may want to choose a loan officer who is connected in your community and has to face either you or your loved ones in the future. It is often more difficult to mistreat people when you may have to look them in the eye in the future (although, that didn't seem to stop Bernie Madoff, so we should always be diligent). Possible places to find such a person include:

- ✓ Service groups like Rotary, Kiwanis, and Lions Club;
- ✓ Business Networking groups (i.e. Provisors, LeTip, BNI, etc.);
- ✓ Community groups (i.e. the Chamber of Commerce or other local groups committed to your community).

How to Read Loan Docs

It is possible to be very clear about the terms of the loan, choose your lender and loan wisely, and still get something completely different at closing. Anyone can make a mistake, even the person drawing your loan documents. If you do not know how to read loan documents, you may not know you got the wrong loan until you receive your first mortgage statement. At that point, it is too late to change it. So here are the most important pages among the stack of loan documents:

1. **The Note and any Riders or Addendums** – These documents clearly describe the terms of your loan. They spell out the rate and term of the loan (i.e. 30 years), if it is fixed or adjustable, and if you have a pre-payment penalty or not. If you do not read this and you get a bad loan, few judges will sympathize with you. So read it. If you do not understand any part of it, ask your loan officer to explain things to you until you do understand. **PLEASE CLARIFY ALL IMPORTANT TERMS OF YOUR LOAN BEFORE YOU SIGN ANYTHING!**

2. **The Estimated Closing Costs** – This document will list all the fees you will pay. The fees here should line up with the fees you were quoted earlier. If your lender signed and completed the protection form provided with this book, you will want to make sure no fees were added without good reason and explanation—and that the rate and loan type are consistent with those promised. If you do not understand any of the fees, ask someone to explain them to you.

It is a very good idea to ask the escrow officer or the attorney to send you the Note, Riders, Addendums and Estimated Closing Statement for your review before you go in to sign the loan docs. This will give you plenty of unpressured time to read and understand them.

CARDINAL RULE: DO NOT SIGN DOCUMENTS YOU DO NOT UNDERSTAND!

Full Disclosure Forms

To aid borrowers in understanding their loans, I created full disclosure forms which clearly state all the terms of the various loan types. In the case of adjustable rate mortgages, the form also asks the lender to calculate the best and worst case payments you could experience when your loan adjusts. For a fixed rate loan with an “interest only” option, the lender is asked to calculate your principal and interest payment when the interest only period ends.

Life is always a balance of risks and rewards. These disclosure forms help you easily understand the risks and the rewards of your loan, so that you can make an informed decision about the future of your home financing.

These forms are in plain English, in a large font, and are easy to understand. They include ALL the important terms of the loan you are receiving. When I was researching this book, I read the fine print of the loan documents for an “Option ARM” I used to have. I did not read the fine print at the time because I was well aware of the terms of the loan—it’s my business to be aware of them. I was surprised to see that my own loan documents did not disclose how my new payment will be calculated if I reach the maximum loan balance allowed.

That is unconscionable! How can borrowers determine if the risks they are taking on are worth the rewards, if they do not fully understand the risks? Luckily, we have some wise people in the California State Attorney General’s office. They called that lender to task.

The forms I created cut through all the confusing language and lack of full disclosure, and require the lender to **fully disclose all terms and risks associated with your loan**. I created an Excel calculator that will help you determine the highest and lowest payments you can expect for your loan. To download it, go to www.HollyHomeLoans.com, click on the “Calculators” tab, and choose “ARM Risk Calculator”. If the calculated possible payments show you that your payment could perhaps double in 5 years, you may either decide to take a different loan, or you may decide to protect yourself by saving more money to cushion the blow if you have to keep the loan when it adjusts, and the payment adjusts upward. Full awareness is all about being prepared for the worst, but focusing on the best.

To get the form for your specific loan, go to www.HollyHomeLoans.com and go to the “Consumer Protection” tab. Copies are also provided in the back of this book. Each loan type has its own form. Ask your loan officer to complete the form that addresses your particular loan type as soon as your loan is locked. If your loan changes for any reason, I recommend asking him to update the form.

Chapter-by-Chapter Synopsis

Following is a list of each chapter with a brief description, so that you can determine if reading a particular chapter is a wise use of your time.

Chapter 2: Protecting Yourself from Bait and Switch Scams - The Bait and Switch chapter clears any naïveté about being fully protected by legislation. It is only possible to partially protect us with good laws. Our best protection is to be well-informed and to have good laws. Chapter 2 helps you understand the importance of choosing a trustworthy loan officer, and how to spot the signs that your loan officer may be dishonest. **It also tells the truth about mortgage ads. You won't rely on rate ads again after learning the truth (either published, or heard on TV or radio).** Legislation passed in 2009 endeavors to correct much of these practices. But it is too early to tell how it will pan out in real life.

Chapter 3: Junk Fees Unmasked - Illegitimate “junk” fees are sometimes added by lenders and closing agents to increase their profits without being straightforward with you. This chapter helps you identify which fees are legitimate (and should be expected), and those that are junk fees and do not represent any legitimate service performed on your behalf.

Chapter 4: Anatomy of a Mortgage Loan: How Points Really Work - Here, I unveil the back room part of the mortgage business. One of the methods that unethical mortgage lenders use to cheat clients is to capitalize on the confusion surrounding paying points. This chapter explains concisely how points and rebate really work. Often borrowers are quoted a “no-points” loan, and assume that they are getting a better deal than if they pay points. That may or may not be true. You will learn how to determine if you want to pay points or not.

Chapter 5: Choosing a Lender: Bank or Mortgage Broker, which is best for you? - This chapter helps you decide whether to go to a bank or broker for your home loan, and helps you choose a loan officer who is right for you. If you do nothing else to protect yourself, *please choose an honest loan officer who has your best interests at heart.* Most borrowers should avoid the “salesman” types who litter the mortgage industry, both bankers and brokers. I describe in detail the differing characteristics of a loan officer and a salesman, so that you can make an informed choice.

Chapter 6: Can You Afford This Loan? - I think this is the single most important chapter in the book. If you have an honest loan officer, you may not need to read many of the other chapters, but this chapter is still important to read. It helps you assess what you can *really afford* with your individual lifestyle, and to determine the mortgage payment that will allow you to sleep peacefully knowing that you can afford to stay in your home. There is no way to do justice to

the goal of ensuring you choose a loan you can afford without reading this chapter and doing the exercises.

Chapter 7: Defining Home Loan Types - Here I explain in detail the characteristics of the most common home loan types:

- ✓ Fixed rate mortgages;
- ✓ Adjustable rate mortgages;
- ✓ Government guaranteed loans;
- ✓ Home equity lines of credit and second mortgages;
- ✓ Construction and Rehab loans.

Chapter 8: Hybrid ARMs in Depth - A Hybrid ARM loan is a loan whose rate is fixed for a number of years, after which the rate adjusts. You probably know this loan type as a “5-year fixed loan,” “10-year fixed,” etc. If you are considering a Hybrid ARM loan, you will want to read this chapter. It will help you understand all the important aspects of this loan type, so that you can choose the best one for you.

Chapter 9: Option ARMs in Depth - If you are considering an Option ARM loan (a.k.a. a Negative Amortization Loan), please read this chapter. It is critical that you know how this loan operates before you decide to get one. The Option ARM loan is excellent for the right person, but it can be disastrous if used improperly, or if you agree to one with a high margin. This chapter clarifies all the important aspects of Option ARM loans. It describes the people who could best benefit from having one and those who should not choose one.

Chapter 10: Truth or Consequences - Knowing what can happen when your loan adjusts can save you countless hours of grief in the future. When we are prepared for the worst-case scenario, it rarely hits us. If we experience it at all, the pain is usually lessened by our preparation. This chapter walks you through the minor calculations necessary to determine what can happen when your loan payment adjusts. If you have an Option ARM loan, it helps you calculate the worst payment you could experience if it recasts, so that you are prepared if the unthinkable happens (and I hope to help you avoid it)!

This chapter also walks you through a “loan check-up.” It is a good idea to do a loan check up well in advance of your loan adjustment date. Prevention is the best medicine!

Chapter 11: A Simple Way to Compare Loans - Mortgage ads can be very misleading. Lenders often quote low rates at zero points, but do not disclose other important information. That important information can sometimes be discerned by the APR quotes, but often it cannot. Trying to compare loans by using the lenders’ quoted APRs can be like comparing apples to oranges. To determine your best loan, you need to compare apples to apples. This brief chapter helps you calculate an APR that cuts through the games lenders can play, and helps you choose the

best loan among those available to you. It also explains what you need to know about adjustable rate mortgages to compare them fairly.

Chapter 12: Know What You Are Signing! Loan Docs Explained - This is the second most important chapter in the book. As I mentioned earlier, your loan officer can be very honest, and yet the person drawing the docs can make a mistake and accidentally give you the wrong loan. If you know where to look for the terms of your loan, you can rest assured you are getting the loan you expected to receive. This chapter gives you examples of important documents and shows you where to look for critical information.

Chapter 13: Are “Stated Income” Loans Bad? - This is a very brief chapter about the pros and cons of “stated income” loans. Stated income means that the lender does not require verification of income to approve the loan. I added this chapter because I want to get the word out that the lending industry’s over-reaction to the liquidity crisis may cause *another crisis* in the future. Stated income loans were used improperly in the past. No one disagrees with that fact. But that does not mean they should not be used at all. In fact, when used properly they are as safe as fully-documented loans, and a great deal more efficient for the lender and **fairer for the borrower**.

Chapter 14: Final Thoughts: A New Paradigm for Foreclosure Prevention - In this chapter I present a simple suggestion that I believe will help good people who have temporary setbacks prevent foreclosure.

Chapter 15: Glossary of Mortgage Terms - The final chapter includes the most commonly-used mortgage terms defined simply.

Chapter Summary:

Now that you have done the bare minimum by reading this chapter, my hope is that you will continue to read the chapters that apply to you so that you can be fully protected. You can protect yourself from becoming a con man’s victim when you get a home loan with the knowledge and tools provided in this book. But, more than that, you can ensure that you choose a loan that will comfortably fit your lifestyle. This chapter briefly covered:

- ✓ There are wolves in the lending industry that are looking for unwary victims. You don’t have to become one of their “kills.”
- ✓ “Junk fees” are any fees that do not represent legitimate services offered you.
- ✓ Do whatever you need to do to ensure that you work with a good, honest loan officer. That is your best defense against abuses.
- ✓ Be sure you read and understand the docs before you agree to the terms.
- ✓ The forms provided with this book will help you ensure honesty during your loan process.