# CHAPTER EIGHT

# MONEY, MONEY, MONEY!

## The Financial Side of Home Ownership

Money can't buy happiness, but it can buy a really nice place to live. You can bet that the millions of Americans now renting apartments would be quick to buy their own place if only they had the money. As a homeowner, you've cleared that hurdle already. Feels good, doesn't it?

But there's more to the financial side of home ownership than saving up enough for a down payment and earning enough to make the mortgage payments. You'll want to keep an eye on your lender or mortgage service company to make sure you're not the victim of costly accounting errors. You'll want to make sure your family would have enough money to pay the mortgage if something happened to you. When interest rates drop, you'll want to know how to decide whether or not to refinance. If you run into financial problems, you'll want to know your legal rights and responsibilities--and what your lender can do to protect its interest. And when the glorious day arrives when you have enough money, you'll want to know how and when to pay off your mortgage so you'll own that home free and clear.

So here's a chapter dedicated to money, a poor master that is nonetheless a good servant.

## MANAGING YOUR MORTGAGE

When you closed on your home, chances are your lender or mortgage service company gave you a fat book of payment coupons to tear off and include with each monthly payment. The coupons and tubs declare the amount you owe each month so it's easy to keep track.

Mortgage payments are almost universally due on the first of each month. Many lenders allow a two-week grace period, then charge a late fee on payments received after the 15th. But don't get in the habit of sending your payments late; if you're persistently delinquent, your lender may be entitled to accelerate the loan.

On the other hand, if all you do is dutifully pay what you're told, you might be paying more than you have to. In some cases, a whole lot more. Be vigilant; keep tabs on your monthly statements. Here are some areas to watch.

## Change in Servicers

When you get a new or refinanced mortgage, don't be surprised if your lender promptly sells the mortgage to a mortgage service company, because many banks don't keep residential mortgages in their portfolios. It has nothing to do with your payment history or the quality of your loan, but these banks don't consider mortgage servicing to be cost effective. If your loan is sold, you'll get a welcome letter with instructions to send your payment to a different lender, and (perhaps later) a new coupon book. (If the coupon book doesn't arrive before you have to send the next month's payment, write your loan number on the check and send it on time.)

What if you have an **escrow account,** in which your lender sets aside part of payment to cover your taxes and insurance premiums? It's your old servicer's responsibility to inform your insurance company and taxing authority of the switch. You might want to make a few calls, though, to make sure the bills are sent to the new servicer. Ditto for mortgage life and disability policies.

If your mortgage is paid through an automatic draft or electronic funds transfer, it's up to you to cancel that arrangement and fill out new forms to set up a new one with the new servicer. This takes time; keep tabs on the switch and be prepared to send a check yourself to make sure you don't miss a payment date. If you accidentally send a payment to the old servicer, chances are it'll be forwarded, but in case of a merger or takeover the old servicer may not exist and your payment could take the slow route through return mail. So be sure to follow the instructions in your welcome letter.

Don't switch where you send your payments, though, until you've gotten word from your original lender confirming that the loan has indeed been sold to that company. There's a scam for every type of transaction, and mortgage servicing is no exception. Some homeowners have gotten phony letters informing them that their mortgages have been sold and directing them to send their payments to a new address--where they go into the pocket of a resourceful scam artist. If you haven't heard about a transfer from your original lender, call to see whether it's legitimate.

Even a legitimate switch in loan servicers can spell trouble. You might send your payment on time to the new place, but get hit with a late fee because the new loan servicer doesn't have its computer geared up for recording payments on its new portfolio of mortgages. Or the new servicer might recalculate your escrow and decide you owe more than you think--due immediately.

Since 1990, federal law has required loan originators to give borrowers 15 days notice if their loan is to be transferred. The letter is supposed to identify a toll-free or collect number to call with questions. If a borrower sends a payment to the old servicer, the new one can't charge a late fee within 60 days of the transfer. And if you contact the loan servicer with a payment dispute, the company can't report your overdue payment to a credit company for 60 days.

Although this law is designed to protect consumers, it hasn't stopped all transfer-related problems. Even with a clear-cut error, it's often very difficult to get the new lender to acknowledge the problem and get it straightened out. If you discover an error and you're getting nowhere with the company, contact your state office of savings and residential finance for consumer assistance.

## Escrow Charges

Your mortgage lender has an interest in making sure your property is adequately insured and that your property taxes are paid. Accordingly, the law allows lenders to require you to pay money into an escrow account, from which the lender pays the insurance premium and tax assessment (your tax and insurance bills go directly to the lender).  It's sort of like enforced budgeting, to make sure you don't come up short when it's time to pay.

Veterans Administration (VA), Federal Housing Administration (FHA) and private mortgage insurance (PMI) loans always require escrow accounts for insurance premiums and property taxes. Conventional home loans may or may not, but many lenders routinely include them in the conditions for making the loan. Whether or not you have to escrow your payments may be negotiable, but the time to negotiate is at the outset. Lenders like having the use of that money until the payments are due.

In most states, lenders don't have to pay interest on escrow accounts, so it's free money for them. In California, Connecticut, Iowa, Maine, Maryland, Massachusetts, Minnesota, New

Hampshire, New York, Oregon, Rhode Island, Utah, Vermont and Wisconsin, state law requires lenders to pay interest. Federally-chartered banks, though, are exempt.

The question is how much money mortgage holders have to put into escrow. It's a bit tricky to monitor because money is going in and out of your escrow account as your mortgage payments come in and the lender makes your insurance and tax payments. Federal law limits escrow accounts to the amount needed to pay two months worth of each borrower's obligations. That is, if the lender is to cover $1,200 in tax payments and insurance premiums, that's $100 per month, so the lender could collect enough of your money into escrow to make the payments while maintaining a $200 cushion in case of unexpected increases. At some time every year, the account should be down to that $200 figure.

This is a complex enough process that a significant number of escrow accounts have either too much or too little of the borrower's money. A recent HUD study indicated that more than 10 percent of American home mortgage escrow accounts are illegally high, but nearly 25 percent aren't high enough to cover the lender's expenses. In those cases, lenders essentially advance homeowners the money to make the required payments. So your lender's escrow practices might actually be in your favor.

In many cases, though, homeowners are paying more into escrow than they need to. Loan servicing companies often change the way they figure the escrow on newly purchased loans, resulting in sudden, major increases. You have a right to see a summary of your escrow account activity, to make sure payments are being made on time and check how much you're paying in and how much is going out. If your escrow account or your monthly payments seem too high, ask for an explanation. Lenders are allowed to keep no more than two months' payments (plus fifty dollars) in your account. If you find a mistake, you can demand a refund. New escrow rules from the

Department of Housing and Urban Development require lenders to refund excess money. (See box, opposite for information on mortgage monitoring companies.)

## Adjustable Mortgage Rate Errors

If you have an adjustable rate mortgage (ARM), your interest rate changes periodically depending on what's happened to the prime rate. Because your lender didn't have to guarantee a set rate for 15 or 30 years, you probably started with a lower interest rate than people with fixed-rate mortgages--a good deal if you may not keep the house more than a few years anyway.

Lenders use several formulas for determining what the rate will be each period, such as two points over a particular Federal Home Loan Bank District's cost of funds, or one point over the yearly average rate for one-year Treasury bills. Check your disclosure statement to see what formula applies in your case. If your lender uses a different formula than agreed, the error can add up over the years to hundreds or even thousands of dollars.

Likewise, if you prepay principal, it's important to make sure the prepayments are actually applied to principal. Otherwise, you may end up paying more than you owe.

Ferreting out such errors is tricky business, because you need to know your way around amortization tables to see what's going on. As with escrow errors, an accountant or a mortgage monitoring company (see box) could check your statements for you and see if there's an error in the lender's favor. In nearly half the cases, however, errors are in the borrower's favor.

## Private Mortgage Insurance

Private mortgage insurance (PMI) is different from mortgage life insurance, which pays off your mortgage if you die (see below), and from homeowner's insurance, designed to replace your home and possessions in case of fire, theft, etc (see chapter four). Lenders often insist on PMI if you have a low down payment, such as only 5 percent, on an original loan. The idea is to protect the lender's interest; if you default on the loan, the insurer will cover the lender's losses. As home prices have outpaced buyers' incomes, the number of conventional mortgages carrying PMI has grown to nearly 30 percent.

The problem is that PMI, which costs about 0.3 percent of the loan per year, doesn't self-destruct when it's no longer needed. When you've built enough equity in your home, your lender wouldn't need PMI any more to protect its interest because it could come after your equity. But nothing in the PMI policy says when it can be dropped, and it doesn't disappear without your taking some initiative. Many homeowners pay for PMI year after year when they shouldn't have to.

Some lenders and investors require PMI for the entire term of the loan. That's a matter to negotiate if you refinance; make sure you can drop it when you reach a certain level of equity. Typically, the threshold is 20 percent equity. But few lenders will allow you to drop it if you've missed a payment; even a few late payments can make it tough to remove.

If you live in an area where property values are rising and you've been diligent about your payments, it shouldn't be a problem to negotiate removal of PMI once you've reached 20 percent equity. Contact your lender or mortgage servicing company and explain why you shouldn't have to pay it any more. There's no set rule; it's decided on a case-by-case basis. You might be able to show that your home's value has increased enough that the remaining mortgage is less than 80 percent of the current appraised value. For that argument you might need a new appraisal, which could cost you  $250-$350. But if you can show what similar homes in the neighborhood have sold for recently, you may be able to convince your lender without one.

## HOT DEALS

The pitch from your banker arrived in the mail yesterday, and it looks like a really good deal. Maybe it's a mortgage life insurance policy designed to pay off your mortgage balance if, heaven forbid, you should die suddenly and your loved ones couldn't make payments on the house. Maybe it's a home-equity loan that would consolidate all your bills into one lower, monthly, tax-deductible payment. Or maybe it's a good rate on a second mortgage that could give you the money you need to build that addition. What a deal! Should you go for it?

Think twice. Lenders are quick to offer financial plans to protect or expand your mortgage, promising to help you cope with your financial problems, real or imagined. But while some of these are merely unnecessary, others can draw you deeper into debt than you already are--and the price you pay for slipping up is your house. Talk it over with a savvy adviser you trust--and not the one who's trying to sell you on the deal.

Here are some of the mortgage-related deals you may be offered, with some thoughts on what they can and can't do for you.

### Mortgage Life Insurance

Although you can buy mortgage life insurance at any time, it's a standard extra offered by banks before closing. "You want this, don't you, to make sure your family could meet the mortgage payments if you died?" Basically, it's a special kind of term insurance, which either pays off the mortgage or covers the monthly payments if the insured dies. Two homeowners can typically be insured for roughly half again the premium, so the policy pays if either one dies. A surviving spouse who received a lump-sum benefit could invest the money and use the interest to make mortgage payments.

As with any form of life insurance, the premium depends on your age. If you're under 35 it might cost less than $10 per month, compared to, say, $135 per month if you're 65. The premium on an existing policy doesn't necessarily increase, though, as you get older. To cover the premiums, your lender increases your monthly mortgage payments.

One variation is disability insurance, a separate policy that would cover your mortgage payment for, say, up to two years if you were disabled. Since temporary disability is more likely than premature death, premiums might run $20 per month for a monthly benefit of $700. Again, they'd be added to your monthly mortgage payments.

Although it's a good idea for families to buy some kind of life and disability insurance to protect their home, you can probably get a better deal than the policies offered on a take-it-or-leave-it basis by your lender. One reason is that you have no opportunity to compare costs. Term insurance premiums and benefits vary quite a bit from one company to the next, and you're better off shopping around.

Although mortgage life insurance is better than no life insurance at all, its premiums are the highest per thousand dollars of coverage of any form of life insurance. Any kind of life insurance could be used in part to pay the mortgage. In fact, enough straight term insurance to cover expected needs is probably a better idea because the benefit level remains constant. The benefit paid by mortgage life insurance decreases as you pay down the mortgage, because it only covers the amount still owed. An equal amount of level term insurance doesn't cost much more.

Be especially skeptical of mortgage life insurance if you've been paying on your mortgage for quite a few years. By that time, your debt has decreased so much that you could be paying hundreds of dollars per year to cover a small balance. Chances are you'd be well advised to cancel the policy.

Since mortgage life insurance is designed to help a homeowner's spouse and children, it makes no sense at all if you're single. Not unless you want your parents or whoever inherits your estate to get your house debt-free.

## Second Mortgages and Home-Equity Loans

A home-equity loan sounds appealing because it promises to free up the equity you've built in your home--the difference between what your home is worth and what you owe on it. Maybe you want to redo the kitchen but need extra cash to do it. Maybe you'd like to consolidate all your bills by borrowing enough on your home's equity to pay them all off, leaving you with a single, lower monthly payment. Either way, the interest is tax deductible. In pitch letters from the bank, it sounds pretty good.

Really, though, a home equity loan is just a glorified second mortgage. A typical lender will loan you 75 or 80 percent of your home's appraised value, less what you owe on it. Interest rates are higher than for first mortgages because of greater risk for the lender. You're putting your home up as collateral on the loan; if you can't pay it back (while keeping up with your regular mortgage payments), the lender has a right to foreclose. So be sure you know what you're getting into.

These loans take two basic forms. A standard installment-type second mortgage, also called a home-improvement loan, is for a given amount of money at a fixed rate of interest for a stated term: say, $10,000 at 9 percent for 15 years. You get the money in a lump sum along with a second coupon book. You pay a set amount per month over and above the payments you make on your first mortgage. A home-equity line of credit is flexible both in what you borrow and how much interest you have to pay. Based on your equity, the lender gives you a set of checks to use as you need the money, up to a certain credit limit. When you draw on your credit line you activate an adjustable interest rate, typically one percentage point above the prime rate (if interest rates start climbing, you may be in for more than you expected). As with a credit-card account you have to make a minimum monthly payment, such as 2 percent of the balance or a stated flat sum. But you're probably only paying interest; the principal is due in a balloon payment (a huge payment due at the end of the term, to make up for the very low monthly payments) when the line of credit expires.

Both home-equity lines of credit and standard second mortgages involve $100 to $400 in closing costs, including a title search, appraisal and recording fee. Some lenders also charge points, say 1 percent of the loan amount in extra interest up front.

If you decide to go for this extra cash, which form you choose will depend on your needs. If you need a set amount all at once, say to add a room to your house, a fixed-rate second mortgage can reduce the temptation to use the money (and run up your debt) for other purposes. If you're remodeling in stages or putting a child through college, the flexibility of a home-equity line of credit might be better. But think long and hard before you commit yourself to either type. Remember, you're betting your house on your ability to pay back the money.

Home-equity loans packaged as bill-consolidation loans are especially tempting if you've run up a lot of bills, because the interest rates are generally lower than for credit cards or auto loans. You can indeed lower your monthly payment, but in most cases you're agreeing to a longer payback term than you had before. A car that would have taken only three or four years to pay off will now take 10 or 15. If you have $20,000 of credit card debt at 18 percent, you can replace it with a $20,000, 10-year home equity loan at 12 percent. By the time you're done, though, you'll have paid $40,000 in principal and interest.

Worse, if you're the kind of person who runs up bills and has trouble paying them, what if you need to buy a new car before you pay off that second mortgage? Many people who take out a bill-consolidation loan to pay off their accounts find they have credit available again--and can't resist the temptation to use it. But if you get into yet another installment credit deal, you'll be in worse shape than you were before: a mortgage, a second mortgage, and another pile of bills.

You could incorporate the new bills into a renewed consolidation loan with a bigger monthly payment, but that would free up more credit and make it possible to get even deeper into debt. When it's finally time to face the music, you'd realize that the bill consolidation loans converted ordinary, unsecured credit into fully secured mortgage debt. That means your lender has a right to foreclose on your house and have it sold to pay it all off.

## REFINANCING

If you bought your home a few years back when annual interest rates hovered around 11 and 12 percent, you may be shaking your head over the mortgage deals people are getting. If only you'd waited! But if you're willing to go through the hassle of refinancing, you can save a great deal of money over the term of the mortgage. You also might be able to switch from a 30-year mortgage to a 15-year, so you can pay off your loan in half the time with roughly the same monthly payments.

Although some might claim otherwise, no one really knows where interest rates are heading. If they start climbing, you'll be glad to have locked in a low rate.  If they drop even further, you can refinance again in a year or two. Even if you refinanced just last year, it may be worth your while to do it again if interest rates have fallen a point or two since then.

Especially if your loan is fairly recent, you may be able to go back to the lender who wrote your original mortgage and sign a few papers. Savings and loans and small town banks, which often keep mortgage loans in their portfolios, are often willing to modify a recent existing loan rather than risk losing your business. Instead of refinancing, which means paying off the loan and replacing it with a new one, you cut a deal with the lender to bring the existing loan in line with the market. The new rate might be slightly higher than what you could get if you refinanced, but the costs could be significantly lower because the lender knows your payment history. For loans originated within the past few years, some lenders require only a one-page loan modification form and a fee of, say,  $750. Ask your lender if a loan modification is feasible in your case.

Likewise, if you hold a VA or FHA mortgage you can probably renegotiate your loan rather than refinancing. Both agencies offer a process they call "streamlining," designed to provide more favorable financing for people who've made their payments on time and who don't want to increase the size of their loan. After all, homeowners with the wherewithal to make their existing mortgage payments would be perfectly capable of making lower ones. Ask your lender about streamlining your loan.

Otherwise, refinancing can be a major hassle because many banks routinely bundle up their mortgages and sell them to a mortgage service company, which collects mortgage payments from the homeowners and makes sure insurance premiums and property taxes are paid. If the bank keeps any papers on the loan at all, they're outdated. So if you go back to your original lender to refinance, it may be essentially the same as starting over--with application fee, survey, title insurance, points and closing costs.

## Should You Refinance?

Refinancing shouldn't be a big deal, but it usually is. The process is surprisingly complicated, takes a good two months and can cost nearly as much as getting a new loan.

Is it worth the effort? That depends on your circumstances. The old rule was to do it if you could lower your interest rate by at least two percentage points, because it would take that much savings to cover the fees associated with refinancing. In today's competitive market, though, lenders are falling over themselves to get your business. Many are offering to eliminate application fees, points or other loan fees, which can make it less expensive for you.

Experts now advise homeowners to work from how long they expect to own the home. Ask a lender you're considering what the closing costs and monthly payments would be for refinancing your loan. Divide the closing costs by the amount you'd save each month. That will give you the number of months you'd need to keep the home to recover the cost of refinancing.

Suppose you have a $100,000 30-year, fixed-rate mortgage at 9.5 percent, which requires a monthly payment of $840.86 for principal and interest. You replace it with a similar mortgage at 7.8 percent, requiring monthly payments of $719.88. That's a monthly savings of $120.98. Now suppose you have to pay three closing points, or $3,000, plus $250 for an appraisal fee and $350 for title insurance, for a total closing cost of $3,600. Divide that number by $120.98 and you get just under 30, the number of months of mortgage savings it would take to recover that cost. So you'd have to own your home for two and a half years before refinancing would really start to pay off. But if you keep it for 12 years, you'll save nearly $14,500.

Not everyone can refinance, though. If you're one of the unfortunates whose property value has plummeted in recent years, you may have trouble finding a bank willing to refinance. That's because the amount remaining on your loan is more than your home is now worth, and mortgage lenders are bound by strict state and federal guidelines spelling out the percentage of current value they can lend. You can't get a new loan without having a certain amount of equity in the home. If possible, consider cashing in a chunk of your savings and paying down the existing loan far enough to permit refinancing.

Generally speaking, you can refinance if your home is worth 10 percent more than the loan amount. If you buy private mortgage insurance (PMI), you can get away with 5 percent. (See above, under "Managing Your Mortgage," for more on PMI).

Even if you can refinance and it pencils out to significant monthly savings, be aware that starting over on your loan means you'll end up paying more in interest than you would otherwise--especially if you've been paying on your loan for quite a few years. Lenders allocate your month's payment first to pay whatever interest you owe for that month, then apply whatever's left to principal. Out of an initial payment of $1,800, maybe only $10 goes toward the principal of the loan; the rest is interest. It's several years before you start making significant payments toward the principal; at about year 12 of a 30-year mortgage, payments to principal and interest are roughly equal. Check your most recent statement to see how much of your latest payment went to principal and how much went to interest.

If you're to the point where you're making significant inroads on the principal, starting over with a new loan means you'll be back to paying almost all interest. Many people never intend to stay in a house long enough to pay off their mortgage, but if you think you will, it might make more sense to build equity even faster by prepaying some of your principal. Of course, that would mean paying more each month (see below for more on prepaying).

## Fixed Rate or Adjustable?

As with your original mortgage, if you refinance you'll have to choose between a fixed rate and an adjustable-rate mortgage (often called ARM). Instead of having a set interest rate over the term of the loan, an ARM is adjusted periodically within a set range. Your loan documents might specify adjusting the rate every six months, every year or every three years. Often the standard is one percentage point over the prime rate set by the U.S. Treasury. It's possible to switch from one form to the other for a modest fee.

Do you plan to stay in your home for 10 years or more? In that case, your best bet is probably the certainty of a fixed-rate mortgage even if the initial rate of interest is a bit higher. Since the cost of money could be much higher a few years down the line, lenders charge more for fixed-rate mortgages. But if you see rates dropping even further, you can always refinance again in a couple years.

If you're only planning to keep the house another two or three years before trading up or moving elsewhere, you might as well get the lowest rate available--an ARM. These are often discounted the first year to make them especially attractive, but watch out for "sucker" adjustables that skyrocket after the first few months. Even with a normal ARM, be aware that interest rates could surge unexpectedly, leaving you with a higher monthly payment than you'd planned on. That's bad news if you're barely making it as it is, or if you or your spouse is unable to work for awhile.

If you already have an adjustable-rate mortgage and interest rates have dropped considerably since the last adjustment, you may be able to lower your interest by asking your lender to make the adjustment earlier than scheduled. Many are willing to make this modification for a small fee.

You might be offered a "balloon note," which is amortized like a 30-year mortgage but has to be paid off with a huge final payment in five or 10 years. The problem is that you don't know what your circumstances will be at that time; you could be disabled or unable to qualify for refinancing. The only balloon note to accept is one that guarantees refinancing at the rate then current.

## Pinning It Down

Be sure to shop at several banks, thrifts and mortgage companies to see what deals are available. A mortgage broker can help you shop around, but get recommendations from people you trust before engaging one. For more on what to compare, see box, above.)

Before settling on a refinancing deal, you might want to engage a lawyer to look out for your interests and make sure everything is filed properly. Some states require using lawyers; otherwise, it's a matter of personal preference.

Ask plenty of questions and make sure you get straight answers. Beware of "bait and switch" tactics, where a mortgage broker gets your business with the promise of an especially good deal then claims he couldn't get it past the lender. Ask for a written list of all fees, then check the list at closing to make sure no extra charges have been slipped in. Also check all the numbers twice at closing to make sure, for instance, that your latest mortgage payment has been credited.

If your old lender has some of your money in escrow for property taxes and insurance (see p. 4-6 of this chapter), don't expect to get that money back right away. Lenders often keep escrow funds up to 60 days to cover outstanding tax or insurance bills. When you do get the refund, make sure your premium or taxes weren't paid by both lenders.

## FINANCIAL PROBLEMS

When you applied for a mortgage to buy your home, the lender made sure you'd be able to manage the payments on the income you had then. But what if you or your spouse is laid off, your income plummets and you can't make your payments?

Your mortgage documents allow your lender to take steps to recover the money you owe. In some states, that might be if you're even a few days late. Most states, though, provide homeowners with legal protections designed to give them time to make good on their contract. Depending on state law, you have a certain amount of time--typically 90 days--to cure the mortgage by making up the delinquent payments. Accordingly, most lenders wait four or five months before accelerating the loan or starting **foreclosure**.

If you can't cure the mortgage within the specified time, the lender has a right to accelerate the mortgage, declaring the entire amount due. Unless you can come up with the money, the lender could then foreclose on the property and order it sold. Because many states require a judicial foreclosure in which all parties come before a judge, the process takes eight months to a year, although it might be shorter if you're not living in the home.

If the property is sold at a public auction and the proceeds aren't enough to cover your principal and back interest, plus late charges, legal costs and unpaid property taxes, the lender may still come after you for the difference, called a **deficiency**. You'd have no home but still owe a chunk of money.

If your lender is starting foreclosure, one way to salvage your credit record is to put the house on the market immediately. Sell it as fast as you can, even if you have to cut the price terribly. Then use the proceeds to pay off your mortgage (assuming you can sell the house for at least what you still owe). You can do this right up to the end of the redemption period. In many cases, lenders back off to allow time for the house to sell; after all, it's likely to net them more money than a sheriff's sale. And you may come out of it with enough to start over.

Another option if you don't have much equity in the home is just to hand your deed over to the lender and call it even. The lender might be willing to clean up your credit record in exchange for the deed, to save the time and trouble of foreclosure.

## Fending off Foreclosure

If you expect trouble making payments, though, don't just let it slide and hope your lender doesn't notice.

Begin by negotiating with your lender. Explain the situation and see whether the lender is willing to adjust your payment schedule, lower your interest rate temporarily or let you make payments only on the interest until you're back on your feet. Not all lenders are willing to do this, but many would rather help you work through this difficult time than go to the expense of foreclosure, then lose again when the home is sold by the sheriff for less than it's worth.

If your lender won't budge, see a mortgage broker or a different lending institution about taking out a loan based on the equity you have in your home. Use that loan to make your primary mortgage payments. The rates and fees for such loans are pretty high, but it might buy you some time.

During this period, watch out for con artists who get wind of your troubles and promise to help you with various quick remedies. Some claim they can arrange refinancing, while others say they can get you a loan to pay off your debts. Supposedly you'll be borrowing someone else's credit by obtaining a cosigner on a new loan, who will cure the default and make payments for several additional months until you're back on your feet and able to start repaying.

These deals, known as "equity skimming," actually involve selling the house for less than it's worth and leasing it back to you. You get to stay in the house as a tenant, under a lease that gives you an option to buy the house back within a certain number of months. Your rent covers the new mortgage payments. But like any tenant, you could be evicted if you can't fork over the rent.

The real catch is that option to buy it back. The deal expires in six, 12 or 18 months, at which time you have to come up with enough money to pay for the entire house or it's gone. Of course, given the financial troubles that led you into this mess in the first place, there's no way you can obtain that kind of money unless a rich uncle dies; no bank is going to lend you what you need. The result is that the kindly soul who offered to help you with your problems has actually cheated you out of your house. You don't even get your equity back.

These deals are patently illegal because they defraud the hapless homeowner. The transaction has all the trappings of a loan and that's what the homeowner thinks it is, but it's really a sale and leaseback. The perpetrator's real purpose is to get your home for next to nothing.

## Bankruptcy

If you're having trouble making mortgage payments, you may also be in trouble with credit cards, auto loans, back taxes and other debt. Creditors are beating down your door and you don't know what to do.

Now's the time to discuss your options with an experienced bankruptcy lawyer. If you're poor or unemployed, you may be entitled to free legal services; consult your local legal aid office.

Although you'd never want to damage your credit rating unnecessarily, our country's bankruptcy laws can protect you from losing everything to your creditors. By taking some steps before it's too late, chances are you can save your home.

Bankruptcy can take several forms, depending on whether you're an individual or a business, how much debt is involved and what you want to accomplish. For homeowners, the basic options are Chapter 7 and Chapter 13.

- **Chapter 7 bankruptcy,** also called a straight bankruptcy, discharges most of your debts. Alimony, child support, student loans that have been due less than seven years, most taxes, and certain other debts can't be discharged. Any assets you have that aren't exempted by law are turned over to a bankruptcy trustee to divide up among your creditors.

What you can keep depends on where you live. Although the Federal Bankruptcy Code keeps most aspects of bankruptcy uniform throughout the country, exemption laws vary wildly from state to state. If you go bankrupt in Delaware, you only get $500 in personal possessions, including schoolbooks, clothing, tools, a piano, a sewing machine and the family Bible. In Virginia, you can keep, among other essentials, a cow and a calf, three hogs and a horse.

Some states have a **homestead exemption** that allows you either to keep your home or to retain a certain amount of equity in your home, in addition to ordinary household furnishings, tools of your trade and personal items. In Texas, Iowa and Florida, for instance, you can keep your home no matter how much it's worth and how much equity you have in it, although you still have to pay any mortgages on it. Texas, which was settled by debtors, also allows an acre of land in the city or 200 rural acres, plus $60,000 worth of personal property. In Illinois, you're allowed $7,500 of equity per person or $15,000 per couple. In many states, the homeowner must be the head of a family to get a homestead exemption.

Your bankruptcy attorney will advise you as to the steps you need to take to claim the homestead exemption. If it's not done right, one of your creditors could force the sale of your home

If the equity you have in your home is below the maximum allowed in your state's homestead exemption, you could declare bankruptcy with respect to your other debts but **reaffirm** your home mortgage, which means keep making payments on it in exchange for being able to retain the property. Most people who do this figure that going bankrupt on their other debts makes them better able to save their home.

If you have more equity than your state allows you to keep and the bankruptcy trustee in your area is aggressive, you might be required to sell your home to pay your creditors. But if you're in that position, a competent lawyer would advise you to stay away from Chapter 7. That's when Chapter 13 makes more sense.

- **Chapter 13 bankruptcy** is a way of reorganizing your debts to allow you to pay most of them and work your way through this difficult time. It's designed for individuals and mom-and-pop businesses with less than $350,000 in secured debt (such as mortgages and car loans) and less than $100,000 in unsecured debt (such as credit card debts and medical bills). It only works if you'll be earning money steadily during the term of the bankruptcy.

  Basically, the law requires you to submit a plan for making payments on your debts over the next three or five years. During that period, as long as the plan has been approved by the bankruptcy trustee and you're abiding by the plan, creditors can't hound you, garnish your wages or sue for payment. It's not up to your mortgage lender or other creditors to approve it or deny it. If your plan complies with the law, they have no choice in the matter.

  A typical reorganization plan, drawn up with the help of an attorney who specializes in bankruptcies, provides for paying secured creditors what they're owed, or at least the value of the collateral, and paying unsecured creditors a percentage of what they're owed.

  Chapter 13 is a tool often used to help beleaguered homeowners keep their homes. After all, if you lose your home because of bankruptcy, chances are you won't be able to buy another one for a very long time. Most lenders refuse to issue mortgages to people who've declared bankruptcy until a good two or three years after they're out of bankruptcy.

Here's how it works. Suppose you're three mortgage payments behind and your lender is talking foreclosure. Get a good lawyer and file Chapter 13. The lawyer will help you figure out how much of your income you need for regular mortgage payments and living expenses and how much you could apply to your debts.

When you draw up the plan for repaying creditors, include those three payments along with your other debt. But inform your lender that you'll be keeping up with future payments, making one payment per month as usual outside the plan. That way you can make up the missed payments bit by bit over three to five years, along with back taxes, missing payments on your auto loan and maybe some money toward credit card debt. You'll cure the default on your mortgage, so the lender will no longer be in a position to foreclose.

It's possible to file Chapter 13 after foreclosure, or even during your redemption period. Doing so puts the brakes on the whole process and buys you time to get your affairs back in order.

Of course, Chapter 13 is still a form of bankruptcy and it wreaks havoc with your credit rating. It'll take years to rebuild your credibility, even after you've worked through the plan. And Chapter 13 plans have a high failure rate; it takes a lot of hard work to make a go of it. Still, in many cases it's your best bet for saving your house and getting on with some semblance of a normal life.

## PAYING OFF YOUR MORTGAGE

What if you're on the other side of the prosperity curve and have enough money to pay down your mortgage earlier than scheduled? Should you pay it off completely and be done with it? That depends on your circumstances. It's usually a good idea to make extra payments on your principal if you can, because that can reduce the term of the loan by several years and save you a bundle in interest. It's easiest to keep track of if you make each prepayment for the exact amount of principal due the following month. For each of these payments, you cut a month off the term of the loan.

Whether to pay off your loan completely depends on how much extra money you have. It's not a good idea to pay off your mortgage if it's going to leave you strapped for cash; you may need a cushion later for emergencies. If you're paying relatively high interest, you might want to refinance the loan to get a better rate (see above). When you make that final payment, get a **Certificate of Satisfaction of Mortgage** (sometimes called a **Deed of Reconveyance** or a **Release of Deed**.) This document states that the loan has been paid in full. Have it signed by the lender, notarized and entered in the public records. If you've been paying to a previous owner rather than a bank, this document is just as important as one from a bank. Ask your lawyer to draw up the certificate, then send it with a return envelope. If the seller balks, ask your lawyer to apply a bit more pressure because it's important to have that document.

If the bank agrees to file the document, wait a few months and then check with the county register of deeds to make sure it's been done. If not, do it yourself. If the lender was holding an abstract for your property, you should get it back now. If you were paying into an escrow account for tax and insurance bills, ask to see what's left in your account and get a refund.

Then sit back and relax. Legally you've been a homeowner for years, but now it's really and truly yours.

**Sidebar: NEED HELP?**

If you're worried about paying too much into escrow or getting the short end of a mortgage rate error, but you're not sure how to sort through the figures, one option is to engage a mortgage monitoring company. For a fee ranging from $75 to $300, depending on the complexity of the case, these companies will examine your mortgage records and identify overcharges. They claim they find errors in one out of three mortgages. If an error is found, you can either pursue the problem yourself with phone calls, letters and complaints, or have the mortgage monitoring company try to recoup the money for you. Some charge a percentage of whatever they recoup, typically 35 percent.

Here are three leading mortgage-monitoring companies:

Consumer Loan Advocates, (708) 615-0024

LoanTech, (800) 888-6781

Mortgage Monitor, (800) 548-8282

**Sidebar: SHOPPING FOR A REFINANCING DEAL**

If you're thinking about refinancing, take time to shop around. These days lenders are scrambling for a chunk of the refinancing market, sending out promotions designed to grab your attention with their low interest rates and minimal closing costs. Competition has led to a wide range of options, so don't jump on the first offer that comes your way. Check with several mortgage bankers, savings and loans and other lending institutions.

If you're considering a fixed-rate mortgage, be sure that you're comparing annual percentage rate (APR), which factors in points (interest paid up front), rather than the "simple" interest rate, which doesn't include all the costs of closing.

If you're looking at an adjustable-rate mortgage (ARM), the Federal Trade Commission recommends comparing:

- initial interest rates
- the "cap," which is how much the rate can increase over the life of the loan
- how often the interest rate can change
- how much and how often the monthly payments and term of the loan can change
- what index is used to determine rate changes
- what "margin" is used (how much more a lender can add to the adjusted interest rate)
- any "balloon" payments (a large payment due at the end of the term, to make up for low monthly payments)
- the limits on "negative amortization" (loss of equity when payments are so low that they don't fully cover the interest rate charges, so you owe more at the end of the year than you did at the start).

If you find a promising deal, don't rely on it without having the lender give you a written "lock-in" (also called a "rate lock" or "rate commitment"). This is a guarantee that the lender will hold a particular interest rate and number of points for you for a specified period while your loan application is being processed. Otherwise, things could change by closing time. Some lenders charge an application fee of $200 to $500 to lock in rates, which may not be refundable if you don't close for some reason. Others don't. Ask if any application fee can be applied to other charges if the loan goes through, and refunded if it doesn't.

Click here to go to Chapter 9