The top 6 mortgage mistakes

1. <u>Adjustable Rate Mortgages</u>

Adjustable rate mortgages seem like a homeowners dream. An adjustable rate mortgage starts you off with a low interest rate for the first two to five years. They allow you to buy a larger house than you can normally qualify for and have lower payments that you can afford. After two to five years the interest rate resets to a higher market rate. That's no problem because borrowers can just take the equity out of their homes and refinance to a lower rate once it resets.

Well, it doesn't always work out that way. When housing prices drop, borrowers tend to find that they are unable to refinance their existing loans. This leaves many borrowers facing high mortgage payments that are two to three times their original payments. The dream of home ownership quickly becomes a nightmare.

2. <u>No Down Payment</u>

During the subprime crisis, many companies were offering borrowers no-down-payment loans to borrowers. The purpose of a down payment is twofold. First, it increases the amount of equity that you have in your home and reduces the amount of money that you owe on a home. Second, a down payment makes sure that you have some skin in the game. Borrowers who place down a large down payment are much more likely to try everything possible to make their mortgage payments since they do not want to lose their investment. Many borrowers who put little to nothing down on their homes find themselves upside down on their mortgage and end up just walking away. They owe more money than the home is worth. The more a borrower owes, the more likely they are to walk away.

3. <u>Liar Loans</u>

The phrase "liar loans" leaves a bad taste in your mouth. Liar loans were incredibly popular during the real estate boom prior to the subprime meltdown that began in 2007. Mortgage lenders were quick to hand them out and borrowers were quick to accept them. A liar loan is a loan that requires little to no documentation. Liar loans do not require verification. The loan is based on the borrower's stated income, stated assets and stated expenses.

They are called liar loans because borrowers have a tendency to lie and inflate their income so that they can buy a larger house. Some individuals that received a liar loan did not even have a job! The trouble starts once the buyer gets in the home. Since the mortgage payments have to be paid with actual income and not stated income, the borrower is unable to consistently make their mortgage payments. They fall behind on the payments and find themselves facing bankruptcy and foreclosure.

4. Reverse Mortgages

If you watch television, you have probably seen a reverse mortgage advertised as the solution to all of your income problems. Are reverse mortgages the godsend that people claim that they are? A reverse mortgage is a loan available to senior citizens age 62 and up that uses the equity out of your home to provide you with an income stream. The available equity is paid out to you in a steady stream of payments or in a lump sum like an annuity.

There are many drawbacks to getting a reverse mortgage. There are high upfront costs. Origination fees, mortgage insurance, title insurance, appraisal fees, attorney fees and miscellaneous fees can quickly eat up your equity. The borrower loses full ownership of their home. Since all of the equity will be gone from your home, the bank now owns the home. The family is only entitled to any equity that is left after all of the cash from the deceased's estate has been used to pay off the mortgage, fees, and interest. The family will have to try to work out an agreement with the bank and make mortgage payments to keep the family home.

5. Longer Amortization

You may have thought that 30 years was the longest time frame that you could get on a mortgage. Are you aware that some mortgage companies are offering loans that run 40 years now? Thirty five and forty year mortgages are slowly rising in popularity. They allow individuals to buy a larger house for much lower payments. A 40-year mortgage may make sense for a young 20-year-old who plans to stay in their home for the next 20 years but it doesn't make sense for a lot of people. The interest rate on a 40-year mortgage will be slightly higher than a 30 year. This amounts to a whole lot more interest over a 40-year time period, because banks aren't going to give borrowers 10 extra years to pay off their mortgage without making it up on the back end.

Borrowers will also have less equity in their homes. The bulk of payments for the first 10 to 20 years will primarily pay down interest making it nearly impossible for the borrower to move. Besides, do you really want to be making mortgage payments in your 70s?

6. Exotic Mortgage Products

Some homeowners simply did not understand what they were getting themselves into. Lenders came up with all sorts of exotic products that made the dream of home ownership a reality. Products like interest only loans which can lower payments 20-30%. These loans let borrowers live in a home for a few years and only make interest payments. Name your payment loans let borrowers decide exactly how much they want to pay on their mortgage each month.

The catch is that a big balloon principal payment would come due after a certain time period. All of these products are known as negative amortization products. Instead of building up equity, borrowers are building negative equity. They are increasing the amount that they owe every month until their debt comes crashing down on them like a pile of bricks. Exotic mortgage products have led to many borrowers being underwater on their loans.