

## The Basics

### 6 mortgage rip-offs to avoid

Mortgage lenders and brokers have plenty of fine print in which to hide otherwise blatant rip-offs. Here's how to spot six common tricks.

By [Liz Pulliam Weston](#)

Given how easy it is to get skinned on a mortgage deal, it's amazing anyone ever buys a home.

But buy we do—and then refinance, and refinance again. Our ignorance of how the mortgage process works and the many ways mortgage pros rig the system in their favor lead many of us to pay far more than we should.

However, the more you know about common mortgage rip-offs, the better armed you'll be to negotiate a good deal. Here are some of the most common ways that mortgage lenders and brokers dupe their customers, and what you can do to avoid being taken:

#### **I'm not going to honor your rate lock.**

When interest rates are volatile (and when are they not?), it can be smart to “lock in” a rate so you don't face a higher payment if rates rise during the time it takes to process your loan paperwork. A lock is a commitment by a lender to provide a specific rate for a specific time, often in exchange for a fee.

A lending officer or broker may imply, or even state, that you've got a lock. But a verbal promise is worthless.

“Get it in writing from the lender,” advised mortgage expert Diane St. James, a consultant and underwriter who runs [ABC Mortgage Consulting](#). “If you end up going to an attorney, you'll want to have something on paper.”

Even if you get a written commitment, though, you're not out of the woods.

You know how the cops on “Law & Order” sometimes “lose” suspects' paperwork to keep them jailed a little bit longer? Unethical lenders do something similar if they don't want to honor their commitments. It's

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called “running out the lock,” or delaying the loan’s closing until the lock expires and you’re faced with accepting a higher rate.

“If rates go up, they run out the lock,” explained Michael Moskowitz, president of Equity Now, a New York-based mortgage lender. “If rates fall, they honor the lock.”

How can you protect yourself? Some suggestions:

- **Get referrals.** Find out which companies your friends used and whether they were happy with the service they got. Picking a broker or lender at random, using phone books or advertisements alone is just asking for trouble.
- **Check them out.** Look up their complaint records with the Better Business Bureau and your state regulators. (Brokers and lenders are typically regulated by state departments of real estate.)
- **Get your paperwork in on time.** Don’t give them excuses to stall. For more details on what you’ll need to have ready, see [“7 secrets to refinancing on the fast track.”](#)
- **Raise Cain.** If it looks like your lock will expire before your loan is funded, demand to speak to a supervisor and mention you’re going to complain to state regulators if your lock isn’t honored. You also might suggest your attorney is going to get involved. Kicking up a real fuss may be enough to convince them to stop playing games, at least with you, Moskowitz said. “Why pick on you,” Moskowitz said, “when there are a lot of other people to pick on?”

### **I’m getting a bonus for putting you in a more-expensive loan.**

This little scheme can work a lot of different ways, but here’s one of the more common ways it plays out:

You call a broker and are quoted a rate of 6.5% with no points on a 30-year fixed rate mortgage. By the time you’re ready to lock in, the lender’s rate has dropped to 6.25%. But the broker doesn’t tell you that, and instead locks you in at 6.5%. As a ‘thank you’ for selling the more-expensive loan, the broker gets a payment of a couple thousand dollars from the lender, and you get stuck with higher payments.

Amazingly, this is usually legal as long as it’s disclosed in your paperwork—but you typically don’t get the notice until your loan is about to close, and the disclosure is usually buried deep in the legalese.

Lender payments to brokers for selling higher-cost loans are known as “yield spread premiums,” and they’re incredibly widespread. One Harvard University professor who has studied the issue, Howell E. Jackson, estimated that these premiums affect 85% to 90% of borrowers and average \$1,850.

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Brokers insist this is a legitimate way to do business and cover their costs. But consumer advocates say, at the very least, that they should be better disclosed.

The best way to protect yourself from the most egregious overpayments is to do lots of footwork:

- **Know what a competitive offer looks like.** The loan savings calculator at [MyFico.com](http://MyFico.com) can give you a rough idea of what rates to expect, given your credit scores, while quotes from online sites like ELoan and LendingTree can give you detailed information on the going rates and fees.
- **Get all your quotes on the same day.** Rates change constantly, and a quote that's good today probably won't be comparable tomorrow. Also, rate-shopping over an extended period can hurt your credit score.
- **Ask lots of questions.** If you're working with a broker, the National Consumer Law Center recommends you demand to know how much the broker is making from the lender as well as from any fees you might be paying. It's best to get this information upfront and in writing. Avoid a broker who's double-dipping: getting a fat premium from the lender as well as fees from you.

### **You'll never get the low rate I advertise.**

If you've done your footwork, you should be able to tell when a rate is too good to be true. If a lender is offering a rate considerably below the competition, there's going to be a catch like high hidden fees, a teaser rate that quickly expires or super-high credit standards that few borrowers will meet.

Again, the best way to find a square-shooter—and a good deal—is with referrals and background checks. Also, make sure you're upfront about your financial situation. Most lenders assume your deal will be fairly straightforward and that you meet the following criteria:

- You have good credit.
- You have stable employment.
- You have a decent-sized down payment and enough cash to cover closing costs.
- You can document your income and assets.
- You're a U.S. citizen or permanent resident.
- You're buying a home you plan to live in (rather than rent out).

If any of these aren't true, you should let your lender or broker know in advance so you can get more accurate quotes.

### **You're going to end up owing more, not less, on your loan in a few years.**

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Most loans require you to pay down your equity over time, so that your balance shrinks a bit each year.

There are a few exceptions. Interest-only loans typically don't require principal payments for the first five to 10 years (for more details, see "[Could you handle an interest-only loan?](#)"). And some adjustable-rate mortgages allow what's called "negative amortization," where your balance can actually grow.

This is a feature of the newly popular "flexible payment" or "option" ARMs, which typically give you four choices of how much to pay each month.

One of the choices is usually a low minimum payment that may not cover all the interest that's accumulating on the loan. That unpaid interest is instead tacked on to your principal, so that your balance is getting bigger over time. This process is called negative amortization.

"You borrow \$200,000," St. James said, "and five years later you owe \$210,000."

There are usually limits to how much negative amortization you're allowed, however. Most loans that have this feature will automatically "reset" if your balance climbs to 110% to 125% of what you originally borrowed. That means your payments will suddenly spike, so that you're required to start paying down your principal. Borrowers who aren't prepared for this jump can wind up losing their homes.

Any time you get an adjustable mortgage, you should ask the lender for a schedule that shows how high your payments can go and how much you'll owe after five, 10 and 15 years. If you have more than one repayment option, ask for a schedule for each one. You want to see the worst-case scenarios, not the best. And don't listen to arguments that rates "won't" or "can't" hit their caps. Nobody can predict the future of interest rates.

### **I'm misleading you about your rate cap.**

Here's another problem with flexible-payment ARMs: People are getting confused about their caps.

The typical ARM allows your interest rate to rise no more than 2 percentage points a year, or 6 percentage points over the life of the loan. A 1-year ARM that starts at 5.5%, for example, could jump to 7.5% in 12 months or a maximum of 11.5% by the fourth year.

But many people with flexible-payment ARMS think they have lifetime interest-rate caps of 7.5%, Moskowitz said—either because they didn't understand what they were being sold, or they were deliberately misled.

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What they actually have is a 7.5% *payment* cap. That means if their monthly payment is \$1,000, it can rise to \$1,075 in the second year, \$1,156 the third year and so on.

"Their actual interest-rate cap might be something like 12%," St. James said. If the borrower's interest rate is rising more rapidly than the payments, the unpaid interest is tacked on to the principal amount—creating the negative amortization discussed above.

Again, the best way to avoid surprises is to have the lender give you a schedule of payments that shows the worst-case scenarios. Then you can make an informed decision about whether this is the right loan for you.

### **Your 'no-cost' loan is going to cost you a bundle.**

We're back to the adage, "If it sounds too good to be true, it probably is."

Every loan has costs: for appraisals, title insurance, underwriting, etc. The lender may be tacking the fees on to the loan principal, or charging you a higher interest rate than you would have paid had you covered the costs yourself.

In rare instances, St. James has seen lenders offer truly no-cost refinancings, where the borrower got a competitive rate and no fees were tacked onto the loan. But the deals were so-called "streamlined" refinancings for existing customers the lender didn't want to lose. If you walk in off the street, you're going to pay for the loan one way or another.

You might very well choose to pay a higher rate for a "no-cost" loan if you plan to be out of the home in a couple of years. But if you plan to stay longer, it's often a better idea to pay the costs out of pocket.

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