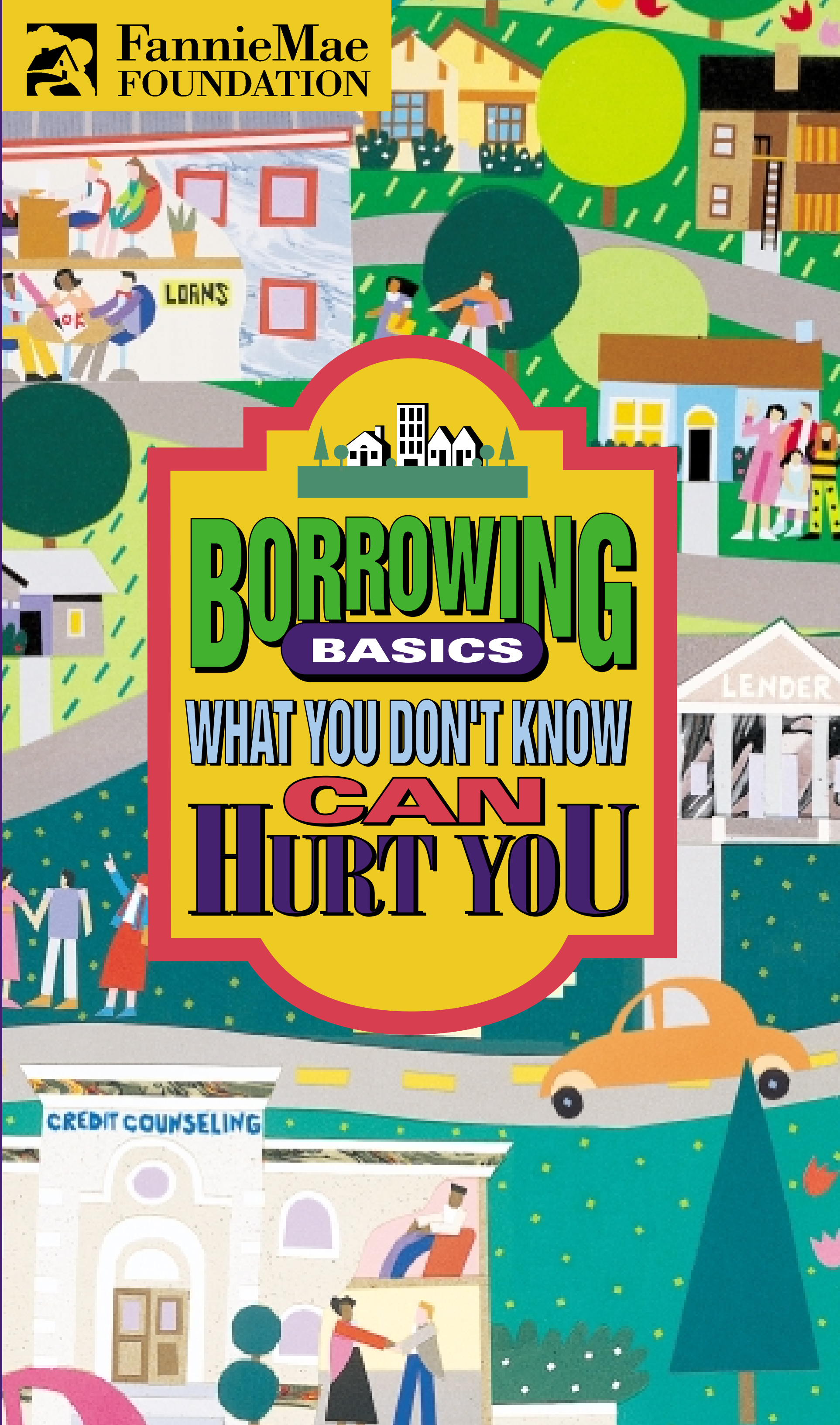
FannieMae FOUNDATION

BORROWING BASICS

WHAT YOU DON'T KNOW CAN HURT YOU



How the Fannie Mae Foundation can help.

If you're like most Americans, homeownership is a major part of the American dream. The Fannie Mae Foundation can help you understand the steps you will need to take to reach that dream. Or, if you already own your own home, we can help you keep that dream alive.

Homeownership is a big responsibility, one that you will need to accept for many years. It is worth the effort, though. Whether you are thinking about buying a home or already own one, the Fannie Mae Foundation can help. We are a nonprofit organization that, among other activities, provides useful information to Americans about homeownership.

Getting the facts.

Almost everyone needs to borrow money to buy a home, repair it, or make major purchases. Understanding the facts about loans can be difficult, so as a public service, we provide *Borrowing Basics: What You Don't Know Can Hurt You*. We hope this information will help you make the right decisions.

When you hear "Need money? Bad credit? No credit? No problem!" followed by promises of easy money, watch out! A loan from such a source could end up being a costly mistake. If you agree to such a loan and then fall behind in your payments, you can ruin your credit. You can also lose your cash savings, car, home furnishings, or even your home!

Most lenders value their customers and want to give them the best possible loan options. If you need to borrow money and your credit is good—or can be improved with extra effort—you may qualify for a loan with reasonable interest rates. Just make sure that the loan is for only the amount you need, is from a source you can trust, and has a monthly loan payment you can afford.

What is predatory lending and how can it affect you?

Most lenders are trustworthy—but unfortunately, some lenders are not. They sometimes direct borrowers *away* from loans with more affordable interest rates. Instead, they offer loans that carry very high interest rates, questionable fees, and unnecessary charges. These practices are considered predatory lending.

A predatory lender may be a large company with a name you know. Or it may be a small company or a loan broker you've never heard of. But predatory lenders have many of the same traits. They:

- offer loans based solely on the equity in a home, not on the borrower's ability to repay the loan;
- charge unusually high interest rates for loans;
- add excessive points to a loan without lowering the interest rate;
- include excessive fees; and
- tack on unnecessary costs, such as prepaid single-premium credit life insurance.

With or without these extra charges, you may find it difficult or even impossible to repay the loan. If you fall behind in your payments, more charges may be added. Or the lender may suggest that you refinance the loan to lower your monthly payment. But the unpaid payments may be added to the new loan amount, costing you even more money over time. Then the loan becomes even more difficult to repay. If you can't make the payments, you could lose the items you purchased or used to secure the loan.

Most often, the victims of predatory lenders are low- and moderate-income persons, minorities, and the elderly. But anyone—*including you*—can be misled by a predatory lender. You may want to consolidate credit-card debt or buy your first home. If you already own your own home, you may want to make repairs to it. Your reasons for a loan may be good, but if you agree to an unfair loan, you could lose your home!

Here is an example of what can happen if you're not careful:
The Smiths had always dreamed of buying their own home. They were in their early 30's and had a household income of $48,000 a year. They had experienced some credit problems in the past but had paid their bills on time for two years. Still, they were afraid that their previous credit problems would make it impossible to qualify for a mortgage at a bank or credit union. They were happy to get a letter from ABC Quick Credit that offered "easy" mortgages for everybody.

After talking to the folks at ABC, the Smiths felt confident that they were getting a great deal. They didn't bother to check with other lenders to see if they could get a more favorable interest rate. Instead they went with ABC. The friendly loan officer told them he had helped many others in their situation. Getting the mortgage WAS easy—they received a $90,000 adjustable-rate mortgage, *but at an interest rate of 15 percent with 7 points. And, as a condition of the ABC loan, they also had to purchase credit life insurance for $500.*

If they had shopped around, the Smiths would have realized that they would have qualified for a better loan—a fixed-rate mortgage at 8 percent with 2 points and no credit life insurance. The ABC loan officer had said to trust him—and, unfortunately, that's just what the Smiths did.

At the end of the first year, the mortgage interest rate went up 2 percentage points to 17 percent—and their mortgage payment increased by $145 a month! The Smiths quickly fell behind in their payments. They tried to get help, but it was too late. They lost their home.

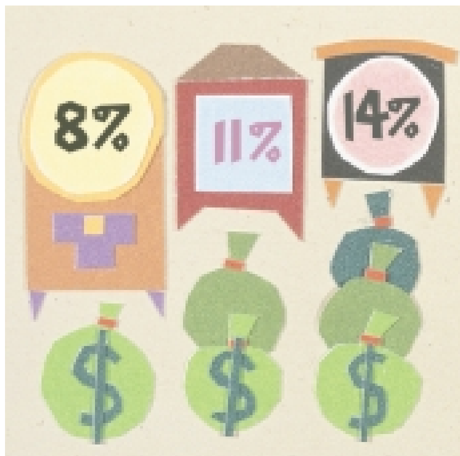
How can you get the best loan?

- **Shop around for the best loan for your situation.** Ask in places where you feel comfortable, such as a bank, credit union, or a local nonprofit housing or consumer credit-counseling agency. To confirm current interest rates, look in the business or real estate section of your local newspaper. Call more than one bank, savings and loan, or mortgage company. The chart below shows how various interest rates for a 30-year, fixed-rate mortgage can affect your monthly loan payment.

LOAN AMOUNT	INTEREST RATES									
	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
$ 20,000	$120	$133	$147	$161	$176	$190	$206	$221	$237	$253
30,000	180	200	220	241	263	286	309	332	355	379
40,000	240	266	294	322	351	381	411	442	474	506
50,000	300	333	367	402	439	476	514	553	592	632
60,000	360	399	440	483	527	571	617	664	711	759
70,000	420	466	514	563	614	667	720	774	829	885
80,000	480	532	587	644	702	762	823	885	948	1,012
90,000	540	599	660	724	790	857	926	996	1,066	1,138
100,000	600	665	734	805	878	952	1,029	1,106	1,185	1,264
110,000	660	732	807	885	965	1,048	1,131	1,217	1,303	1,391
120,000	719	798	881	966	1,053	1,143	1,234	1,327	1,422	1,517
130,000	779	865	954	1,046	1,141	1,238	1,337	1,438	1,540	1,644
140,000	839	931	1,027	1,126	1,229	1,333	1,440	1,549	1,659	1,770
150,000	899	998	1,101	1,207	1,316	1,428	1,543	1,659	1,777	1,897

Loan Amount *Interest Rate* *Monthly Payment*

- **Borrow only the amount you need and can afford to repay.** You may be encouraged to borrow more than you need. So before deciding on a loan, be clear about how you will use the money and how you plan to pay it back. If you are already in debt and having problems making your payments, you probably shouldn't borrow more money. Instead, try to negotiate a payment plan with your current lenders.



- **Understand exactly how much the entire loan will cost.** Review the complete payment schedule. Be sure to find out how much you will have paid *in total* when the final payment is made. Above all, beware of loans with one large "balloon" payment at the end. If you have difficulty making the final payment when it is due, you may have to refinance the loan to make the balloon payment. If your original loan does not guarantee a new loan with reasonable rates, the refinanced loan can cost you even more money because of additional points and fees.

- **Make sure that the loan fees are reasonable.** In most cases, loan fees should not exceed 5 percent of the loan amount unless you are paying more for a lower interest rate. For example, if the loan amount is $70,000, the loan fees should not exceed $3,500 ($70,000 x .05 = $3,500). However, there are some situations that may cause the loan fees to be higher. If you're not sure, ask a trusted advisor such as a nonprofit housing counselor.

- **Read every word in a loan document, and check everything for accuracy.** Don't accept loan terms just because the lender says they are "standard." Make sure you understand the reason for—and effect of—every loan term *before* you sign.

- **Do not be pressured into signing for a loan you can't afford.** But if you do get pressured into signing for a loan you can't afford, act fast. You have a legal right to cancel, or "rescind," a loan contract when your home is used as security for a home-equity loan. But you must generally cancel the loan *in writing* within three business days of signing the loan documents.

What can you do to avoid a predatory lender?

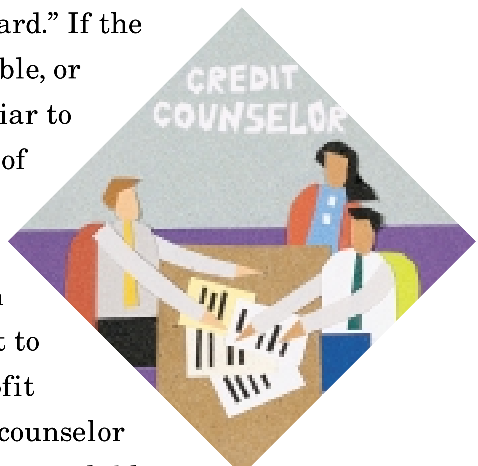
- **Watch out for loan offers from someone who calls you on the telephone or comes to your door without an invitation.** Throw away mail from companies offering to arrange a loan for you. Advertisements promising easy money should be viewed with caution. Remember, if an offer sounds too good to be true, it probably is.

- **Be wary of high-pressure sales pitches, such as claims that an offer is good only for a limited time.** If the offer is good—and legitimate—today, it should still be good tomorrow. Take time to check it out.

- **If you're thinking about consolidating your debts into a home-equity loan, talk to a local nonprofit housing or consumer credit-counseling agency first.** These agencies have your best interest in mind. They may be able to help you work out credit arrangements to avoid debt consolidation altogether. If debt consolidation is the most appropriate choice, they can help you select the best available options. Without their assistance, you may choose a bad loan and end up losing your home.

- **Avoid loans that include extras you don't need.** Loans should not include unnecessary costs like prepaid single-premium credit life insurance. Predatory lenders may require that you purchase a credit life insurance policy as a condition of getting a loan. This is not necessary. These extras will be added to the total cost of your loan and make your payments higher.

- **Never sign an agreement that you don't completely understand.** And don't take a lender's word that an agreement is "standard." If the agreement seems unreasonable, or uses terms that are unfamiliar to you, ask for a complete copy of the loan agreement. Get a second opinion from someone you trust *before* you sign the loan agreement. Bring it to your advisor or local nonprofit housing or consumer-credit counselor to review it. A glossary is also available on page 12 to help you better understand lending terms.



- **Fill in all blank spaces.** If an answer is not required, write "N/A" (Not applicable) in the blank. Do not sign a document until you have completed every space. Someone could fill in the blank later and make you responsible for something without your knowledge or agreement.

Are all loans or credit cards with high interest rates predatory?

No, not necessarily. It is fairly common for bank, department store, and gasoline credit cards to have high interest rates. These cards usually have an interest-free grace period, so you

will not pay any interest if you pay your bill in full every month. And interest rates for a mortgage, home equity, auto, or personal loan are usually considerably lower. The interest rate for your loan may vary based on the lending institution, type of loan, and your personal credit history. Plan to contact at least three lending institutions to compare their interest rates and loan options. You may also want to check the real estate or business section of your local newspaper—or use popular search engines on the World Wide Web—to check current interest rates.

Where can you get help?

You may get helpful information and guidance from a local nonprofit housing or credit-counseling agency. Start by looking in the yellow pages of your local telephone book. Many of these agencies provide *free* services or charge only a nominal fee.

Your local Legal Services or Legal Aid organizations may also provide valuable assistance. Advisors there will review loan agreements. They can also provide guidance if you want to file a complaint against a lender. Your Legal Services or Legal Aid organizations are listed in the business section of your telephone book.

Glossary of Loan Terms

Balloon loan: This is a short-term loan with low monthly payments that are not enough to pay off the entire loan amount, so a balloon, or lump-sum payment, is due at the end of the loan term. This type of loan may have a provision to refinance when the balloon payment is due.

Closing (or settlement): A meeting at which the sale of a property is finalized. The buyer pays the mortgage, and closing costs are also paid.

Closing costs: Fees required by the lender at closing. The fees can vary among lending institutions, but may include the application fee, origination fee, points, appraisal fee, title search, title insurance, etc. If you are unsure about any of the fees, ask for clarification.

Foreclosure: The legal process through which a mortgaged property or home may be sold when a loan is in default.

Equity: The difference between the current market value of a property and the amount the homeowner owes on the property.

Fee: Any charge added to a loan.

Home-equity loan: A loan based on the equity that a borrower has in his or her home.

Interest: The fee paid to borrow money. It is a percentage of the amount borrowed.

Points (or loan discount points): A one-time charge by a lender to lower the interest rate on a loan. Each point is equal to 1 percent of the loan amount. For example, one point on a $100,000 mortgage would cost $1,000.

Prepayment penalty: A penalty some lenders charge for paying a loan off early. Check to see if a loan has a penalty and how long it will be in effect. If you plan to make payments before they are due, or think you might sell your home before the loan is paid off, a penalty could be costly to you.

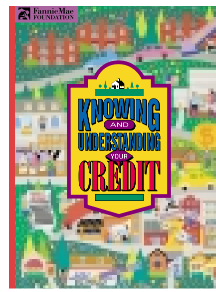
Principal: The amount of money borrowed.

Refinancing: The process of paying off one loan with the proceeds from a new loan secured by the same home or property.

More information from the Fannie Mae Foundation.

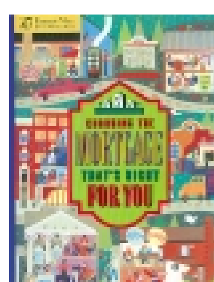
If you want information about how to buy a home, the Fannie Mae Foundation has free guides you can order. They are described below. You can also get information on the Fannie Mae Foundation's Web site: www.fanniemaefoundation.org.

- *Knowing and Understanding Your Credit.* This guide explains why having good credit is so important when you want to buy a home and gives helpful tips on how to improve your credit and maintain good credit. To receive free copies of this guide in English, Chinese, Korean, and Vietnamese, call 1-800-605-5200. For a free copy of the guide in Spanish, call 1-800-541-6300.



- *Opening the Door to a Home of Your Own.* This easy-to-read guide explains the home-buying process, including information on financing and mortgages. To receive the copies of this guide in English, Chinese, Korean, Vietnamese, Russian, Haitian Creole, Polish, or Portuguese, call 1-800-688-HOME (4663). For a free copy of the guide in Spanish, call 1-800-782-2729.

- *Choosing the Mortgage That's Right for You.* This guide will help you learn more about shopping for the right mortgage. To receive a free copy of this guide in English, call 1-800-688-HOME (4663). For a free copy of this guide in Spanish, call 1-800-782-2729.



Borrowing Basics: What You Don't Know Can Hurt You is provided as a public service by the Fannie Mae Foundation. It is not offered, nor should it be relied upon, as legal advice. Consult your legal advisor for assistance with legal problems.

The Fannie Mae Foundation creates affordable homeownership and housing opportunities through innovative partnerships and initiatives that build healthy, vibrant communities across the United States. The Foundation is specially committed to improving the quality of life for the people of its hometown, Washington, DC, and to enhancing the livability of the city's neighborhoods.

FannieMae FOUNDATION

FMF C 096 08/00