ADVICE FOR HOMEOWNERS: REFINANCING DO'S AND DON'TS
What You Should Know About Refinancing

What is Refinancing?

Refinancing is a process in which you pay off one or more existing debts with a new loan. If you have perfect credit, refinancing is sometimes a good way to obtain a lower interest rate or to convert a variable rate loan to a fixed rate. However, if you are in the midst of financial difficulties, if you have too much debt, or if you have bad credit, refinancing is loaded with pitfalls.

We recommend that you be very careful when refinancing debts. Many refinancing loans hurt consumer.

The disadvantages of refinancing may be hidden. This occurs because of:

- hidden fees, costs and prepayment penalties
- changes to creditor remedies and other harsher terms in the new debt; and
- complex provisions that may make a loan look affordable when it is not.

There are even times when a refinancing deal is nothing more than a scam to steal your home.

Twelve Refinancing Rules

1. **When in doubt, do not refinance or consolidate debts.** Caution is always a good idea. Refinancing usually involves significant costs.

2. **Do not refinance because of pressures from debt collectors.** Debt collectors may try to scare you into refinancing because they have no other way to get their money. There are better ways to address debt collection problems than to borrow against your home.

3. **Never (or almost never) use your house as collateral to refinance unsecured debts such as credit card debts, medical debts, or utility bills.** If you have financial problems, unsecured creditors can rarely take your property for nonpayment. But if you refinance and use your home as collateral, the lender can take your home. Note: This rule against refinancing unsecured debt applies even if you can lower the interest rate or your monthly payment in the refinancing process.

4. **If you have an existing debt with a finance company or high-rate second mortgage lender, do not refinance that debt with the same company.** You can ask the company to agree to lower payments on the existing loan, but you should not allow the creditor to write out a new loan, which is likely to involve hidden penalties and expensive new closing costs (or a higher interest rate).

5. **You should not turn a car loan into a second mortgage unless you would rather lose your home than your car.** Repossession is bad, but foreclosure is worse.

6. **Do not refinance low interest-rate loans with higher rate loans.** Make sure that the "APR" (Annual Percentage Rate) of the new loan is lower than the interest rate stated in the

note on the old loan. (The APR adjusts for certain up-front fees in the old loan which you have already paid.) Also, factor in the cost of the insurance, closing costs, and other up-front fees. Treat these as costs of the new loan that could be avoided if you did not refinance. Note: These cautions apply even if your monthly payment is lower.

7. **Keep long-term first mortgages unless you are getting a lower rate.** Lenders may try to consolidate (pay off) a first mortgage (or deed of trust). That is, instead of extending a second mortgage on top of the existing mortgage, they may try to pay off the first mortgage and give you a new first mortgage equal to the old mortgage plus the new loan. Do <u>not</u> let the lender do this unless the interest rate on the new loan is significantly <u>lower</u> than the old first mortgage to offset prepayment penalties and fees and charges.

8. **Be careful about variable rates.** Variable rate refinancing loans can be very tricky. In any variable rate transaction, the monthly payment can increase drastically when you can least afford it. And some loans have artificially low rates (and payments) at the first months that are guaranteed to be much higher in the future.

9. **Do not refinance loans when you have a valid legal reason for not paying that debt.** If you have a legal defense to repayment of a debt, such as lender fraud, you can raise that defense in court. If you refinance with a new lender, the defense will not be available against the new creditor. If you need legal help to determine whether you have a defense, you should get that help <u>before</u> entering the refinancing deal.

10. **Be wary of claims that you will get a tax advantage from a debt consolidation loan.** Many lenders offering bad refinancing deals talk about the benefit of the tax deductibility of mortgage interest. Make sure you understand how your personal tax situation will be affected. (For example, if you can't or don't itemize deductions, the tax deductibility of mortgage interest is worthless.) Overall, you should make certain that the financial advantages of the loan outweigh potential disadvantages including the possibility of foreclosure.

11. **Some refinancing deals are scams. When in doubt, seek help to review the loan papers before signing anything. You can walk away from a bad deal, even at the last minute.** Refinancing involves great potential for hidden costs, fees, security interests and other unfair loan terms. Even some reputable lenders make unfair refinancing deals. Whenever possible, ask a qualified professional to review the refinancing paperwork before you sign. A lender that is unwilling to let you get outside help should not be trusted. Another technique for avoiding scams is to arrange your own financing with a trustworthy lender, rather than letting a contractor or salesperson arrange financing for you. Be wary of loan brokers as well; because some brokers find refinancing deals which involve big commissions for them, rather than good terms for you.

12. **If your home is collateral in a refinancing deal, remember that you have three days to cancel.** When you use your home as collateral for a refinancing transaction, federal law usually gives you the right to cancel for three days. You can cancel for any reason. If you do change your mind, make sure to cancel in writing before the deadline. The lender is required to give you a form for this purpose. Even if the lender does not give you the appropriate form, you may cancel by sending a signed, dated letter to the lender indicating your desire to cancel the refinancing.

REVERSE MORTGAGES AS A REFINANCING OPTION FOR HOMEOWNERS OVER 60

Reverse mortgages are available as a refinancing option for older homeowners who have built up substantial equity in their property. With most reverse mortgage loans, you can draw down your home equity without a repayment obligation over a period of time. Some reverse mortgages have no repayment obligation as long as you remain in the property – no matter how long you stay.

For most reverse mortgage loans, the lender will look at your age, the amount of equity in your home, and the prevailing interest rates, in order to determine the amount it will lend to you. You can then choose how to receive this money – including an option where you get a fixed monthly payment for the rest of your life.

You should be cautious if you apply for a reverse mortgage, just as with any other refinancing option. You can only borrow against your equity once.

The costs involved in getting a reverse mortgage can be very high. Upfront fees for some reverse mortgages are as high as $5,000 or more. Make sure you are dealing with a reputable lender.

A reverse mortgage eats up all your equity (usually within 12-15 years) and usually results in the home passing to the lender when you move or die. Although this should not be a concern if you need to use your equity yourself, you should be aware of this disadvantage, since it may upset your expectations about what you will leave to your heirs.

Reverse mortgages are not for everyone. You should work with a knowledgeable counselor if you are at all in doubt, especially since free counseling is an element of most reputable reverse mortgage programs.

If you do take out a reverse mortgage, set up a plan to use the money wisely. You will not be able to tap your home equity again.

Source: Miami Valley Fair Housing, Predatory Lending Solutions Manual, (March 2001)