Financial Literacy and You

Examining the Pitfalls of Buying Homes and Cars and Taking Out Loans
It started a long time ago. My used car was paid off. And I did not owe a penny to anyone.

I decided to invest in my future instead of paying rent to stay in someone else’s property on their terms.

So I bought my first house at age 23.
I could afford the price of a new home, but...

**THE BANK PUT ME IN A POSITION WHERE I COULD NO LONGER AFFORD A HOME.**

I had to take on another job, and make a lot of sacrifices. But I learned a lot.
BANKS TYPICALLY DO NOT LOAN YOU MONEY IF YOU ARE NOT IN DEBT.

I had never owed anyone any money, so I mistakenly thought I would be a good candidate for a loan. But the bank would not give me a loan. You need to have a debt, to show that you have a credit history.

I had put down almost all of my savings as the down payment on my new home. But I took all the extra money I had and bought a living room couch and chair, and then paid it off in three months. I now had credit. However, I no longer had money in my savings account.
The mortgage officer said:

“THAT’S THE INTEREST RATE THAT EVERYONE IS CHARGING NOW.”

- After paying off my furniture, the bank finally approved my loan. But in the meantime the bank raised the interest rate two whole percentage points above my quote months earlier.
- Does one or two percentage points really make much difference?
- YES!!! And the house that I could have afforded three months earlier was now basically beyond my means, due to the significantly higher monthly payment.
- I did not know enough to shop around. So can you shop for interest rates?
- Absolutely!!!
YOU CAN MAKE OVER $1,000 AN HOUR

- Actually, $1,000 an hour is not accurate.
- The correct figure is closer to $5,000 to $10,000 an hour. If you do a search on Mortgages Sarasota you will get dozens and dozens of hits. Of course, make sure you include your own bank.
- And then call and compare rates and terms for those lenders – at least 5 or 6 lenders. You’ll save thousands!

- Let’s look at Free Loan Calculators and the term What-If.
- Download Excel Loan Calculator or use Online Java Calculator
COMPARE RATES!

Interest rates will vary from bank to bank.

- A 30 year $200,000 mortgage at 4% has a monthly principal and interest payment of $954.83
- A 30 year $200,000 mortgage at 5% has a monthly principal and interest payment of $1,073.64
- A 30 year $200,000 mortgage at 6% has a monthly principal and interest payment of $1,199.10

- On a $200,000 loan, the difference between a 4% rate and a 5% rate is of $118.81 extra a month or $1,426 extra a year. Over the life of a 30 year mortgage, that is a savings of $42,772!
- On a $200,000 loan, the difference between a 4% rate and a 6% rate is of $244.27 extra a month or $2,931 extra a year. Over the life of a 30 year mortgage, that is a savings of $87,937!

Shop around and compare rates.
A few hours of work can save you tens of thousands of dollars.
The mortgage officer said:

“EVERYONE PAYS POINTS.”

- Not only was my mortgage payment higher than the real estate agent quote, but my closing costs were unexpectedly outrageously. They included Points.

- What is a Point?
- Why do banks say they charge Points?
- Do you have to pay Points?
How much does a Point cost you?

- A **Point** is 1% of the mortgage
- A **Point** is a fee charged by some banks so they can make more money on the loan
- In the case of a $200,000 loan, a point is an extra $2,000 that the bank wants to charge you up front for the privilege of taking out the loan
- Only some banks change points – so shop around and you can save thousands of dollars!
The mortgage officer said:

“THOSE ARE ALL NORMAL BUYER FEES; YOU HAVE TO PAY THEM.”

- At closing, I found all kinds of extra fees and expenses that the real estate agent had not warned me about.
- Application fee, loan origination fee, underwriting fee, lender’s inspection fee, appraisal fee, settlement costs, escrow, prepaid insurance, points, and add-ons such as foreclosure insurance, excessive real estate commissions ...
- And the mysterious MIP – more on MIP later.
Aj126 wrote: “I’m not sure how appropriate this question is here but are these closing costs outrageous or do I just need a reality check?”

Asked by Aj126, Houston, TX • Tue Feb 9, 2010

- 801 Loan Origination: $1,206
- 803 Appraisal Fee: $425
- 804 Credit App: $20
- 808 Mortgage Broker Fee: $1,227
- 810 Processing Fee: $545
- 811 Underwriting Fee: $764
- Warehouse Fee: $220
- Application Fee: $295
- Document Prep: $250

“It comes to a total of $13,988.01 closing costs (with down payment) for a $125,000 loan (FHA 3.5% down) We are exploring other lenders tomorrow but I wanted to see what everyone here thought about this.”
RANGE OF FEES FOR A $150,000 HOME WITH A $142,500 MORTGAGE

- 801 Loan Origination Fee
- 803 Appraisal Fee
- 808 Mortgage Broker Fee
- Points
- Application Fee
- MIP

Range
$100 to $1,452 to $2,137
$250-$700
$0 to $1,227.35
$0 to $4,500
$75 to $300
$0 to $125-$250 per month

www.mortgagesfinancingandcredit.org/mortgages/settlement-closing/fees-costs8.htm

Presented by Floyd Jay Winters
So how did my first home turn out?

We literally lived off of my piggy bank of loose change for the next year, and peanut butter became a major part of our meals. But the bank and closing officers made a lot of money off of a very green buyer.

So I vowed that I would not get ripped off like this again. I took a real estate course, became a licensed real estate agent and sold houses for two years. I earned a little money selling houses, but most importantly I learned ...

And I became fascinated with amortization tables. The first major program that I ever wrote was a loan amortization program using an old Apple II computer. But it worked and was accurate to the penny and it allowed me to analyze loans and learn how to play What-If.
MAKE SURE YOUR LENDER GIVES YOU A GOOD FAITH ESTIMATE OF SETTLEMENT CHARGES THREE DAYS AFTER YOU APPLY FOR A LOAN.

IT’S THE LAW

- Certain fees are firm, such as the recording fee, prorated property taxes, and **state tax/doc stamps**.

- However, insurers, lenders and closing agents may try to overcharge you for other services. So **ask, ask, ask**.
INSIST ON A COPY OF YOUR SETTLEMENT STATEMENT AT LEAST ONE DAY BEFORE CLOSING.

This is a requirement of Department of Housing and Urban Development

KIND OF

- Compare the actual HUD settlement statement against your good faith estimate!!!
- What is Title Insurance?
- Who pays for Title Insurance?
- It’s Negotiable

- During my last closing there was a difference of $859.36 (all going to the closing agent/title company) so I wrote on the closing papers “These figures do not reflect the contract or estimated closing HUD statement. Basically, you have us over a barrel. I have no choice, either I pay the made up charges or I have no place to live.”

- Guess what happened?
So my daughter calls me and says...

“Dad, I just bought a house today.”

She had agreed to the full asking price. 😞 Was it too late to negotiate?

Five years later, when she needed a new roof, the bank said “We’ll just roll your existing mortgage and the new roof loan into one convenient payment for you, all at the low rate of 6.325%. And to keep the payment from being too high, we’ll reset it back to 30 years.”

(Her original home mortgage for $180,000 had been at 4.5%.)

Let’s use a loan calculator to look at 25 years vs a new 30 year refinanced loan at a higher interest and see what the bank did to her. Notice how the interest rate percentage is so much higher at the beginning of a loan.
AND LIFE HAPPENS

Years later, very shortly after my daughter bought her second home, the roof started to leak and air conditioner went bad during the same month. But after closing on the new home she had almost no savings, while being faced with $20,000 in sudden bills.

Three types of loan rates as of February 2013

- **Home Equity Loan** at 4.5%-6% with appraisal ($250-$350), recording fee, **doc stamps** and other closing costs. For 20 years.
- **Personal Line of Credit** at 9.50%.
- **New/Used Vehicles** at 1.75% for 5 years.

Guess which loan I took out to pay for the roof and air conditioner?

Yep – I refinanced my car, with no appraisal, doc stamps, or survey cost.
So my son wants to buy a home

He was going to prepay taxes and insurance on his own, so the bank would only charge Principal and Interest.

I asked my son to call the bank and confirm exactly what the mortgage payment would be. When he gave me the number, it seemed about $73 too high. I asked him to call the mortgage officer again and ask for the Principal and Interest, which was the total loan payment. Once again it was about $73 too high, which was $878 per year.
So I called the mortgage officer myself and asked for the exact monthly payment. Again, it was about $73 too high. I said the loan is only Principal and Interest, with no escrow for taxes and insurance. Did you include any other fees? She said no.

Looking at my very accurate loan calculator, I said “You are a LIAR. I want to talk to your supervisor immediately.”

Finally, she admitted that there was an extra $73 extra for MIP: Mortgage Insurance Premium which may be charged if the down payment is less than 20%. But we had put down much more than 20%.

How many people would have just trusted the bank and paid it?
**UNDERSTANDING EQUITY**

- **Equity** is the difference between the home's fair market value – what you could sell it for after paying closing costs – and the outstanding balance of the loan or loans on your property.
- Every mortgage payment consists of a principal and an interest portion. Each month you pay off part of the principal and therefore reduce your loan balance; this increases your equity.
- The value of a car tends to depreciate over time. However, historically, at least until the Great Recession, the price of homes increase or **appreciate** over time. (By the way, the Great Recession was largely caused by the banking industry.)
Understanding Equity Part 2

- For instance, if you bought a home for $200,000 and the average inflation rate or appreciation was 2%, in 30 years the home would be worth over $355,000. At a 4% inflation rate it would worth over $623,000!

- So equity is a combination of your down payment, your principal reduction, and the appreciation in the market value of your home, minus your selling costs. If you play your card right, the equity in your home can be the key to your financial success!
**LET’S SUMMARIZE:** How much money you might save shopping around and doing a little research before taking out a $200,000 loan?

<table>
<thead>
<tr>
<th>Item</th>
<th>Savings up front or per month or per year</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Points savings on a $200,000 mortgage:</td>
<td>$2,000 to $4000</td>
<td>$2000</td>
</tr>
<tr>
<td>Closing cost savings by researching:</td>
<td>$200 to $2,000</td>
<td>$300</td>
</tr>
<tr>
<td>Not paying MIP on a $200,000 mortgage ¹</td>
<td>$82 per month = $984 a year for 10 years</td>
<td>$9,840</td>
</tr>
<tr>
<td>Interest Rate savings at only 1% lower</td>
<td>$118.81 a month or $1,426 a year.</td>
<td>$42,772</td>
</tr>
<tr>
<td>Doing a 20 year loan instead of 30 years ²</td>
<td>Savings from shopping on a 30 year loan:</td>
<td>$54,772</td>
</tr>
<tr>
<td><strong>Total potential savings (after taxes) on a 20 year loan</strong> ³</td>
<td>Total savings in interest</td>
<td><strong>$124,644</strong></td>
</tr>
</tbody>
</table>

1. Technically, a bank can no longer charge MIP once you have 20% equity in your home due to property appreciation or principal reduction. But in many cases, you have to be aware that you have this equity, be aware of the rule, and then you still often have to make a request.

2. Usually you will save more than the $69,732 amount shown, because 20 year interest rates are typically lower than 30 year rates.

3. Note that also during this time the value of your home should appreciate substantially. $124,644 = over $150,000 before taxes.
WHAT DID WE LEARN?

- Educate yourself beforehand
- Ask, ask, ask at every stage
- Shop, shop, shop around
- Learn to Negotiate
- Take advantage to the free Loan programs and learn to play What-If.