The IQ Mortgage Guide

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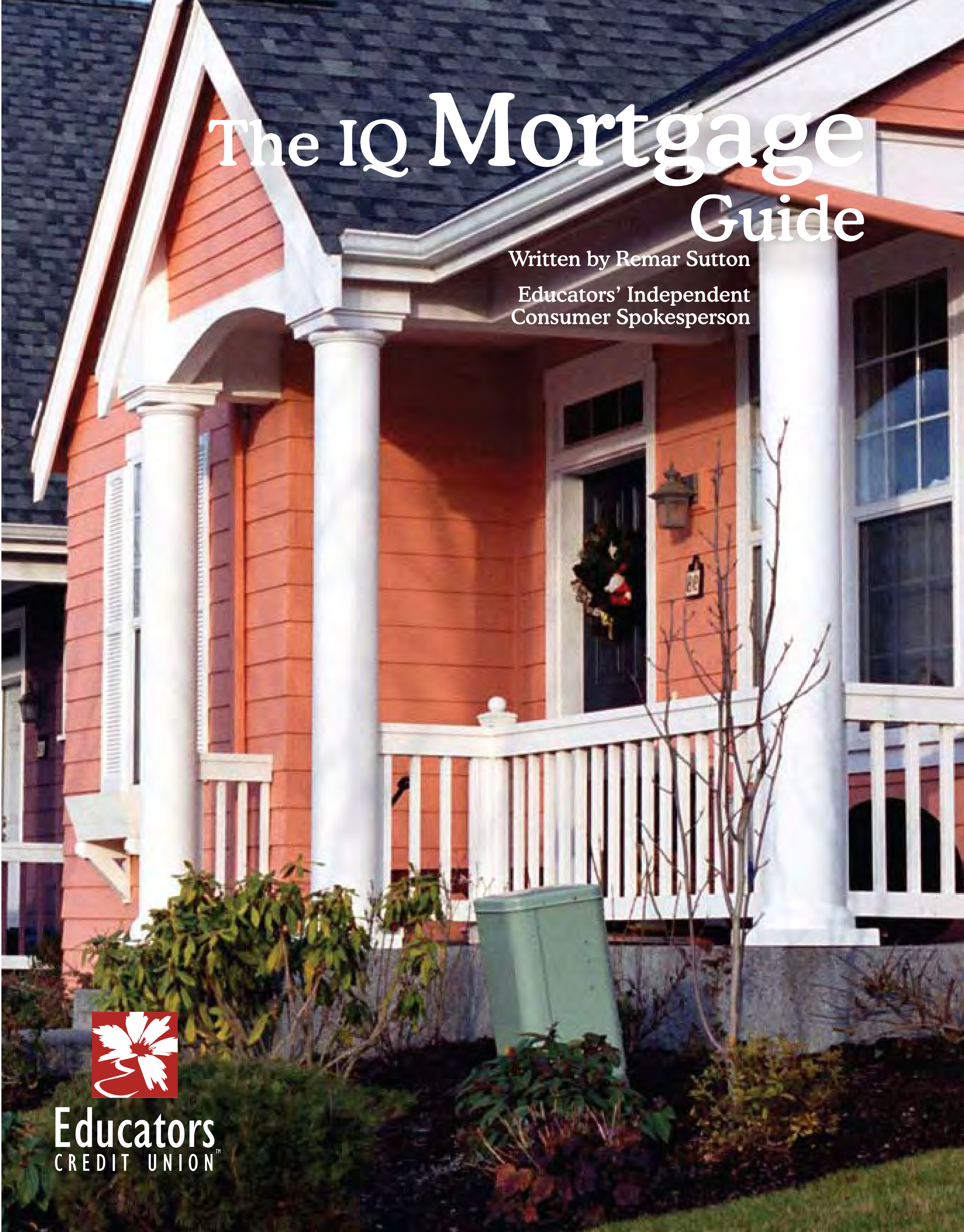

Educators CREDIT UNION™

Introduction

As you're going to learn in this guide, getting the right mortgage is tough, and the penalties for making mistakes are severe.

You won't find cautionary wording like that from most mortgage companies or mortgage brokers, but it's the truth. Make mistakes in the mortgage process, and you can throw away—literally—tens of thousands or hundreds of thousands of dollars, find your life ruled by a mortgage reality you can't change and ruin your credit for at least a decade.

That's why—right now—you need to adopt the first rule of this mortgage guide: **slow down**. And it probably wouldn't hurt you to adopt the second rule, either: **question every company's motives and sales spiel.**

Follow the two rules, and I think you'll come to this destination: Educators. You may not get your mortgage here, but you will get straight answers, and you'll probably make the right mortgage decision because of that.

Am I right? Find out: start reading! And while you're reading, think about checking out "IQ", www.educatorsiq.com, our online consumer education service.

You get different information from Educators. I think you'll find out you get facts, not hype.

Am I right?

Remar Sutton

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Chapter 1: The Perfect Mortgage! Or is it?

The couple was so excited! They'd found a house they loved and even the name of a real estate agent they liked on one of their first drive-throughs of the most beautiful neighborhood in town. Better yet, they'd found a mortgage company that approved them for a whopping loan; $270,000 for 30 years, with no hassle, no closing costs, no "points" and an interest rate two percentage points below the competition.

Better yet, the mortgage was an option adjustable rate mortgage, which cut the payment when interest rates went down, but didn't raise the payment a nickel if the interest rate went up! And they only needed to pay 10 percent down, not 20 percent, like those other companies. The couple grabbed that loan quicker than you could grab a set of free tickets to Tahiti. The payment stretched their budget a bit, but they could handle it.

And were they happy! Until the fifth payment, that is, when the payment unexpectedly jumped $300 per month. Turns out the "lower" interest rate promised by the mortgage company was just a "teaser" rate for the first four months. After four months, the base interest rate jumped higher than the base rate of the other mortgage companies the couple had shopped.

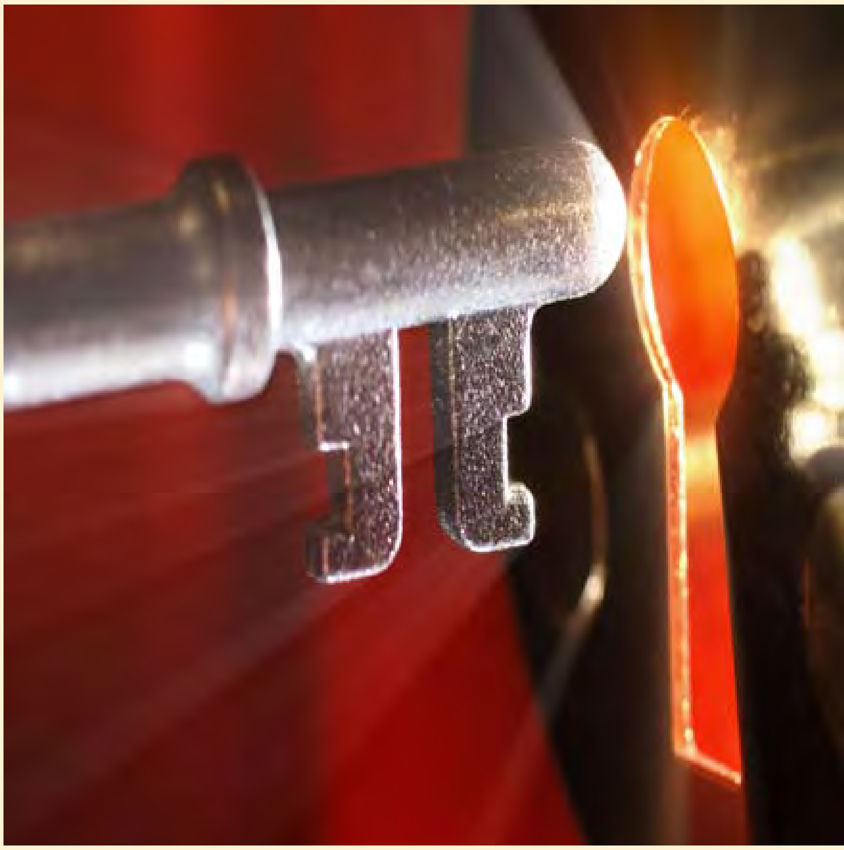
Now the payment really stretched their budget—especially when the couple got their first property tax bill at the end of the year: their property taxes had doubled. No one had warned them property taxes can go up dramatically.

But they struggled with the payment for four years, at least comforted by the thought that their payment hadn't gone up even higher: interest rates during those four years had jumped from 4 percent to 8 percent, but their payment didn't go up a dime. At least something was working right!

Then rates dropped back to 4 percent over a six-month period, and the couple watched each month for their payment to decrease. It didn't. What was wrong? The couple didn't know their "adjustable" mortgage rate was very different from the adjustable rate mortgage plans at the other lenders: their mortgage company's plan allowed the company to delay lowering payments until a full six months after interest rates dropped. Very nice for the company, but not so nice for the couple.

Then his company down-sized, along with his position at the company. Very quickly, the mortgage payment became unmanageable. This couple's only hope was to get a smaller house and a smaller mortgage. That's when the problems really began:

- **Their old mortgage contained an early termination clause.** The couple didn't even know what that meant, but, with sinking stomachs, they understood the mortgage company's explanation: "If you pay this mortgage off early, there will be a $12,000 early termination penalty."
- **Even worse, they had a "negative equity" mortgage (also called a "negative amortization" mortgage) with no "cap".** The couple didn't know what that meant either, but with real terror they understood the mortgage company's explanation: "Oh, you haven't been paying down your mortgage at all during the last four years. It's gone up. It's gone up by $50,000, even after all your payments. Now, speaking of payments, you're late. What are you going to do about that?"



Chapter 2: The Real World of Mortgages

So, you thought buying a car was complicated! Finding the right home and the best and least expensive mortgage makes car shopping look as easy as watching someone else cut the grass. Our example in Chapter 1, for instance, doesn't begin to touch on the mistakes an unwary person can make in this business.

Did you know the best looking home might be the worst buy, even if you can afford it? Most people find that out after they've bought their house.

Did you know two mortgages with the same interest rate could vary tens of thousands of dollars in overall cost to you? Just ask the couple in our example above — thousands of couples have this happen to them every year. How does that happen?

Did you know mortgage payments shouldn't be your only concern when you buy or finance a new home? Lots of folks go broke thinking the payment itself on their dream home is all that counts.

Speaking of payments, how do you know what you can really afford? And who do you trust to show you that critical amount?

Oh, and what type of mortgage should you get: a FRM, ARM, GPM, GEM, PAM, or OOPS? (Most unwary people get an OOPS: "Uh oh, I picked the wrong one!")

And what about saving on "points" vs. interest? Should you do that? How do you know?

And, finally, what if you have a mortgage right now? Should you refinance it? And what if you want to sell your home? How do you do that right?

IQ comes with an important promise:

If an Educators' mortgage isn't better and cheaper than the other company's mortgage, we will send you to the other source. Know anyone else who promises that?

Who Can You Trust on All These Questions?

You can trust us. That's because the IQ Mortgage Guide is about member education. It's driven by information, not by hype. Here's a quick run-down on the guide.

IQ Mortgage Guide: Rather than "You against the world," it's "Us against the world." The cost of a mortgage itself is really a small part of any mortgage or home-buying experience. Dozens of people and companies are grabbing at your pocketbook, and their goal is simple: maximize their profit on you.

We don't operate that way: because you as a member own us, and because our financial stability is based on your financial stability, we want you to conserve money at every step of the process. We therefore are always looking for ways to get the prices down, not up. We're also working hard to help you make the best decision for your pocketbook and your long-term sanity. And the great number of tools we have to help you — either online or in person — are amazing, as you'll see in a minute.

Chapter 3: How Shopping For A Mortgage The IQ Way Works

We use a simple road map to get you to the right home and mortgage. So, are you ready to get going? (Here, we're going to assume you want a new home and mortgage. Later, we'll give you a road map for other scenarios.)

1. When you get in the home-buying mood, slow down! Would it bother you if you threw away $50,000? You can do that on a $200,000 mortgage if you rush. That's why before you begin looking for a new home or a new mortgage, we ask you to do your homework. We'll show you how.

2. For instance, how much mortgage can you really afford? "Pre-approval" is a quick way to learn that magic number. A pre-approval is the most important step you'll take, if you are a smart home buyer. Why? When you're pre-approved you know how much you can really afford to spend on the mortgage payment itself. And don't think the phrases "I'm pre-approved" and "I can afford it" are interchangeable. They definitely aren't. Many mortgage companies approve you for the absolute maximum mortgage payment your budget and your heart can take. But these folks don't tell you that the new mortgage payment virtually always goes hand-in-hand with many other new expenses: improvements for your new home, new furniture, higher real estate taxes and homeowners insurance, for instance. We show you how to budget for all those expenses.

A big difference in applying for a pre-approval with us and applying for a mortgage with other companies: Our credit union historically looks at you, not just at an impersonal, printed credit report. That's particularly important in the mortgage world, where even a single late payment, or a job change can impact your credit — and where some mortgage companies benefit from telling you your credit is worse than it is.

Find out more about our pre-approval process and its benefits at the Educators Mortgage website, ecu.mortgagewebcenter.com. You may also apply online for pre-approval.

3. As part of our pre-approval process, we'll give you a great "heads up" on your credit in general. Some mortgage companies tell you your credit is bad when it isn't — so they can raise rates on you. Other mortgage companies won't give you straight answers about your credit. We'll help you understand where you really stand — and that information is good, even if you don't get a mortgage with us. Educators' "What's Your Score?" program will provide you with an explanation of what it all means.

4. Once pre-approved for a mortgage, you can shop for a home that meets your budget and lifestyle. What qualities should you look for in a new home? Should you use a buyer's real estate agent? Should you have the home inspected? The IQ Home Buying Guide, www.educatorsiq.com/hbg/home_buying_intro.htm, can help you answer these and many other questions.

Find out more about our pre-approval process and its benefits at the Educators Mortgage website, ecu.mortgagewebcenter.com. Or apply online for pre-approval.

5. We'll help you decide which type of mortgage repayment plan is best for you. Many types of loans and repayment plans are available to you. A little later in this guide we'll review the major types. But what's important here is this fact: we'll help you find the plan that is best for your budget, not the plan that simply makes us the most money.

6. We protect you in the closing process. Going to the moon in a homemade rocket is easier than understanding all the complexities and expenses involved with the closing process on a loan. That complexity can cost you money if you're not careful. Our goal here is to make sure you understand each part of the loan-closing process, including the costs associated with "outside" fees, etc.

Chapter 4: Loan Lingo

Do you always want the "premium" product? Well, in the mortgage business, premium equates with "expensive", not necessarily better. To win in the mortgage world, you must understand the basic mortgage language. So, spend a few minutes here and learn to speak another language! Rather than being in alphabetical order, these terms are presented as you will probably hear them.

Mortgagor: You, if you're getting the mortgage.

Mortgagee: The lender.

Pre-qualification: Generally a worthless promotional gimmick used by some lending institutions to entice you into using their product. "Pre-qualifications" are just an informal opinion a lender gives you about your ability to borrow money. You know, "Hey, we like your looks! You can afford to buy the moon, and you'll probably qualify for our cheapest rate, too!" You've heard the same type of spiel from some car dealers: "1.9 percent financing!" But when it gets to contract time, the dealer raises the rate to 14 percent. Don't waste your time with "pre-qualification."

Pre-approved: The real McCoy. A pre-approval, as we said earlier, tells you exactly what you need to know. Some lenders charge you hundreds of dollars for a pre-approval. Educators charges nothing for you to be pre-approved.

FHA and VA: The cousins—governmental agencies that generally help you get an easier or cheaper loan, if they like you. Here's their definitions of "like:"

FHA Loans: The Federal Housing Administration was formed to help persons with lower income buy a home. If you qualify for an FHA loan, your mortgage company may accept a smaller down payment and may have a lower interest rate, too. The FHA doesn't make loans itself; it guarantees that you will pay your loan. (This loan option is not directly available at Educators.)

VA Mortgage Loan: If you are on active duty, a former spouse of a person in the military or a veteran—and if you have enough "eligibility", a Veteran's Administration (VA) loan can be great! VA mortgages don't require any down payment, as long as the value of the house is within certain limits. (This loan option is not directly available at Educators.)

WHEDA: This program is designed specifically for Wisconsin residents that are first time home buyers or that have not owned property in the last 3 years. WHEDA's zero down program requires PMI insurance, which is paid by the borrower. Other programs require a minimum down payment of 3 percent. Mortgage insurance is part of the monthly payment. WHEDA also has limitations on income and on the purchase price.

Conventional Loan: A mortgage loan not insured by a government agency like the VA or the FHA. Conventional loans can be more expensive mortgage loans. What makes a mortgage "conventional"? Usually two things: You're making at least a 5 percent down payment, and/or your mortgage is too big for the government or one of its semi-governmental agencies to insure. The maximum size for FHA and VA mortgages usually changes yearly.

Conforming Mortgage Loan: You want one of these, if possible. A conforming mortgage loan falls within the loan limits set by a government-sponsored agency—either Freddie Mac or Fannie Mae. What's the advantage of a conforming loan? You'll usually get a cheaper interest rate.

Fannie Mae Loans: The Federal National Mortgage Association. Fannie Mae is a quasi-governmental organization. It sets standards for loans, purchases loans and then re-sells them to investors. Mortgage loans that follow Fannie Mae or Freddie Mac's guidelines are usually cheaper.

Freddie Mac: The Federal Home Loan Mortgage Corporation. Freddie Mac is a lot like Fannie Mae; Freddie Mac buys and resells mortgages and guarantees the payment of both principal and interest on those mortgages.

Non-Conforming Loan: (including JUMBO loans) A loan that exceeds the loan amount guidelines of either Fannie Mae or Freddie Mac or does not conform to their standards for some reason. As we said, The Jumbo amount varies and usually changes every year. You pay a higher rate for a Jumbo or non-conforming loan. And you may have to pay more than the normal five percent down.

Points: A "point" (the singular use of the word) is simply one percent of any loan. A point may sound small, but can be very large: If you're getting a $260,000 mortgage, a point is $2,600—certainly not hay, as they say.

Points are used to "buy down" interest rates. For that reason, points used like this are referred to as "**discount points.**" A lender might say, "We'll either give you a 5 percent loan, or we'll give you a 4 percent loan with two points." Of course, they aren't giving you the points; you are paying them the points.

Well, the obvious fair question here: How do you know if you should take a lower rate or pay the points? Generally speaking, if you plan to keep a loan for a long time, you are usually better off to take the lower rate and pay the points. Generally speaking, if you're planning to sell your home in the next five years or so, your best option is to take the higher rate. Remember, mortgage interest is one of the few remaining tax deductions. To compare points and rates, use our tips at ecu.mortgagewebcenter.com.

A new mortgage payment virtually always goes hand-in-hand with many other new expenses: improvements for your new home, new furniture, higher real estate taxes and homeowners insurance, for instance.

How do you know what's best in your specific circumstance, higher rates or points? Ask us. Tell us your plans for the future and we'll recommend the interest rate structure that will probably be best for you.

Assumable Mortgages: These are very rare and it's unlikely you can get one. An "assumable" mortgage means a person with approved credit can pay the equity in your sale price and assume your mortgage when you sell your home. This great feature is a thing of the past, unfortunately, thanks to the savings and loan debacle of the '80s. Assumable mortgages played a big role in that bleak time, and the government and lending institutions have virtually done away with assumable loans.

Contingency Clauses or "Contingencies": Read this section carefully. Contingencies aren't part of the mortgage itself, but are certainly part of the loan process. Contingencies are conditions that have to be met before a contract can be enforced. For instance, you're making an offer on a home, and you're getting ready to write a whopping check. But you haven't been approved for a loan yet; and you're worried about all those funny little things with wings crawling out of the woodwork in the attic; and the seller has told you the lot next door isn't being developed into a fireworks factory—even though a big sign on the lot says "Future Home of Rockets To The Moon"! Being a smart buyer, you make the seller put clauses in the contract that say you don't have to honor it (and you will get your deposit back) under certain circumstances—if, for example:

- You can't get approved for a mortgage.
- You can't get the interest rate you were quoted.
- There are termites in the woodwork.
- The fireworks factory really is being built.

Contingency clauses can also work in your favor if you're a seller, of course. For instance, you might insert a clause in your contract saying any buyer must be able to close the sale within 90 days or the contract is void. What's the real message with contingency clauses? Be cautious when it comes to contingency clauses. Talk to your real estate attorney if you have questions about a specific contingency clause.

Surveys: Drawings which show the boundaries of property, or show any buildings or other "improvements" on that property. Surveys don't tell you what a piece of property is worth, they define the size and dimensions of that piece of property.

Appraisal: Establishes the value of a property based upon comparables. The only appraisal worth anything is called a Certified Appraisal. In most states, "Certified" means the appraiser is licensed and the lender will accept the appraisal as the true value of a specific piece of property. But even certified appraisals can vary, depending upon which certified appraiser is used. That's why we pick an approved appraiser for you from a list of good appraisers.

Impound Accounts: These accounts are established by neutral third parties in a real estate transaction to hold money for the buyer or the seller.

Escrow Payment or Monthly Escrow Payment: Money that you pay each month (over and above your principal and interest payment) that is used to pay your property insurance and property taxes. Escrow is usually only required by lenders if you make a down payment of less than 20 percent.

Earnest Money: A deposit which shows you're a serious buyer and not just a "shopper." This amount is usually held in an escrow account and credited to you at closing.

Fully Indexed Rates: This is another really important term to understand, if you are a borrower. We're going to tell you about Adjustable Rate Mortgages in a minute, but first you need to understand the importance of "fully indexed rates". The fully indexed rate is an interest rate estimate that can be used to compare rates. Some lenders quote you a promotional interest rate to get your loan, but gloss over the fact that the "fully indexed" rate is dramatically higher. This won't happen to you if you deal with Educators.

Teaser Rates: The "promotional" rate we just mentioned. These should usually be called "sucker rates". Don't pick a mortgage based on the teaser rate! The rate will go up.

Prorations or Prorated Fees: If the present owner has paid the property taxes or other fees for the year, but you're closing on the house in the 8th month, you are generally responsible for reimbursing the seller back four months of those taxes and fees since you are assuming ownership of the property for the last four months of the year. Some prorated fees such as charges for a home security service are negotiable.

Closing Costs: Fees the lender collects for processing a mortgage, plus title costs and prepaid items (taxes & insurance). Closing costs vary wildly, and can be paid by the buyer or the seller. If you're smart, you obviously want the other person to pay. *A caution: many real estate transactions regularly fall apart over the issue of who will pay closing costs.* For instance, if you're buying a very hot property, a seller may refuse to pay certain costs because the

seller knows another buyer is in the wings. You have a perfect right to negotiate these costs, but make sure that negotiation doesn't become a "deal breaker", unless you intend it to be.

Closing: The day you've been waiting for! It's the day you take ownership. At this point, we hope you'll be thanking us for the good help of The IQ Mortgage Guide. Read more about what to expect at closing at the Educators Mortgage website, ecu.mortgagewebcenter.com.

In the Glossary, we'll give you more terms. But, spend a bit of time learning the terms here and you'll be smarter and wiser—and probably richer.

Chapter 5: The Many Flavors of Loans

If you can imagine it, it's probably available. There are literally thousands of loan schemes out there. But here's a rundown on the key good and bad mortgage loans, from Adjustable, to Fixed Rate, to Semi-Adjustable-Fixed-Rate-When-the-Moon-Is-Full.

Fixed Rate Mortgages

The interest rate and the payment don't change over the life of the loan. Fixed rate mortgages generally cost more during the first years of a mortgage than adjustable rate mortgages, but they may offer a better deal long-term, particularly if you plan to live in your home for more than 5 to 10 years.

Fixed rate mortgages are available for 15, 20 and 30 year terms. Compared to the 30-year FRM, a 15-year FRM typically offers a lower interest rate but higher monthly payment; the total interest paid on a 15-year loan is substantially less than a 30-year mortgage.

The advantages of a fixed rate mortgage include certainty and security. You know exactly what your costs and monthly payments will be. If interest rates should rise to double digits (and anyone who remembers the early '80s knows that can happen), you need not worry. If you plan to live in your home more than 5 years, particularly 10, 15 or more years, the appropriate FRM is often cheaper in the long-term than most ARMs. Fixed rate mortgages are also simple to understand; they don't have all the "moving parts" you must consider in an ARM.

The disadvantages of a FRM include the necessity to refinance the loan to take advantage of falling interest rates. The fixed interest rate is also usually higher than the initial rates offered by ARMs and therefore in the beginning the payments are higher than the initial payments on ARMs.

Adjustable Rate Mortgages

Also called "ARMs". Most people would give their right arm for a good mortgage like this. ARMs can be good for you, because they allow you to benefit when rates go down. ARMs can be bad for you because they force you to pay more when rates go up. And there are "Option ARMs" that if used inappropriately can lead to financial disaster. But, generally speaking, an ARM is worth considering. A well-chosen ARM may offer several advantages. Because ARMs typically offer lower interest rates early in the loan term, they may offer a lower cost mortgage option for people who know they will be in a home for a relatively short time typically five years or less. This can be particularly true with an ARM that fixes the rate for 3 to 5 years before the first adjustment period. If interest rates fall, an ARM allows you to benefit, at adjustment time, from the falling rates without refinancing. Lower initial monthly payments for ARMs compared to fixed rate mortgages may also allow you to afford more house. Disciplined savers can also invest the money freed up by the lower payment.

But the advantages of an ARM can also be a two-edged sword. If interest rates rise, the interest rate and payments of an ARM can rise sharply over the life of the mortgage. Because initial ARM interest rates are set artificially low, in even the best ARM the interest rate and payments will typically eventually rise higher than a comparable fixed rate mortgage—even if the economy doesn't change. If the economy does spur rising interest rates, even though you have a good life-time cap of 5 or 6 percent you could see your 5 percent ARM rise to 10 or 11 percent in a few years. If you have an ARM where the typical annual cap of 2 percent interest raise doesn't apply to the first adjustment, you could see a large increase at your first adjustment depending on what's happening in the economy. The many variables in ARMs make them more difficult to understand. These are also reasons to make sure that you've done some homework on ARMs before you begin comparing loans. The following information and links will get you started.

ARMs come in many flavors. As we've mentioned a lot earlier, some mortgage companies have ARMs that raise the rate quickly when rates go up, but don't lower it quickly when rates go down. You don't want an ARM like that. All ARMs have the inherent risk that the interest rate will go up, but an appropriate ARM may also allow you to take advantage of a lower interest rate in the beginning of the loan term compared to the interest rate of a fixed-rate-mortgage (FRM). Among the most popular ARMs are hybrids that fix the initial interest for a set period before rate adjustments begin to take place. Fixed periods typically run from 3 to 10 years. Educators offers fixed periods of 2, 3 or 5 years. Once the fixed period ends, rate adjustments typically occur once a year. (Smart consumers will reject any ARM with a shorter adjustment period, such as monthly or every six months.) Because so many factors beyond the interest rate play a role in how much an ARM may cost, evaluating the pros and cons of an ARM can be much harder than evaluating a fixed rate mortgage. If you're considering an ARM, make sure you consider all the terms to make sure they fit your needs.

- Some mortgage companies offer **"Deferred Interest ARMs"**. These are the nice folks who say "Hey, we're your friend! We won't raise your payments when rates go up!" That "too-good-to-be-true" promise is just that. These loans are called "negative equity loans", or "negative amortization loans" and you should avoid them like you avoid dental surgery without anesthesia. In many places these are illegal now.

- **"Option ARMs"** combine an adjustable rate mortgage with a variety of payment options. For example, an Option ARM typically offers you the option monthly of making a minimal payment (negative amortization option), "interest only" payment or conventional amortizing payment based on 30 years or 15 years (your payment applies to both interest and principal). Some Option ARMs even allow you to "skip" a payment. The swiftly rising prices of homes in many regions in recent years led many lenders to push the "flexibility" of Option ARMs and their ability to "put you in more house". Unfortunately, these lenders don't often point out the real hazards. For example, take advantage of the minimum and interest only payments too often and you could owe more on your mortgage than you borrowed or, in a depressed housing market, you could owe more than the home is worth. Recently the news has been full of stories about homeowners who are experiencing this scenario and foreclosures nationally have been rising as a number of homeowners have been unable to meet the higher payments required when their option ARMs "reset".

Interest Only Mortgages

An interest-only mortgage (IO) allows the borrower to pay only the interest on the mortgage for a specified period of time — typically 5 or 10 years. Both fixed rate and adjustable rate mortgages are available with interest-only options. During the "interest-only" period, the monthly payment contains no principal. Because the borrower is paying only interest on the loan, the payment during this period is lower than it would be with a conventional fully-amortizing loan where the payment includes both principal and interest. At the end of the interest-only period, however, the IO loan becomes fully amortizing for the remainder of the loan term. At this point, the monthly payment amount also rises dramatically. During the IO term, the borrower can make payments on principal but such payments aren't required. If no principal payments are made during the IO period, then the borrower builds equity in the house only if its value appreciates. If the value of the house falls, then you could actually owe more on your loan than your house is worth. Interest only mortgages should be considered only with greatest caution.

Balloon Mortgages

Watch out! A balloon mortgage gives you a fixed number of payments, but doesn't fully pay off your loan. At the end of the payments, you'll have a whopping final payment. And you can't walk away from the final payment on a balloon mortgage. If you're very careful, balloon mortgages can be useful in certain circumstances. For instance, if you know for an absolute fact you're going to sell your home in 10 years, a 10-year balloon is a good way to have a lower house payment right now. You can make small payments on your mortgage for those 10 years then pay off your loan when you sell the home in 10 years. The whopping final payment in our example would be paid out of the sale of the home. Sounds very reasonable. But in the real world property values don't always rise and homes don't always sell as quickly as you need to happen, so don't fall for a balloon without doing your homework and taking all the potential negatives into account. Also, talk to us. Good advice is where Educators shines: we won't recommend a mortgage plan that isn't good for you.

"Piggyback" Mortgage Loans

Recent figures from the National Association of Realtors indicate that 42 percent of first time home buyers financed 100 percent of the cost of the home as did 25 percent of all home buyers. If you finance more than 80 percent of the value of your home, however, you must purchase Private Mortgage Insurance (PMI) or use a home equity loan or home equity line of credit to borrow the down payment. This loan used to borrow the down payment is called a "piggyback" loan because you are in essence adding it on to the mortgage loan. More first time home buyers have been choosing the piggyback, most typically as a line of credit loan. The danger? Home equity lines of credit usually have variable rates and no fixed payment schedule. Rates could rise and you could easily have a higher minimum payment as well as a higher payoff.

Bridge Mortgages

A mortgage loan that lets you borrow some of the equity in your home until that home sells. People usually use bridge mortgage loans to help them buy a second house before their first house has sold. Bridge loans can be very dangerous — what if the first home doesn't sell? Can you afford to support two mortgages? Be careful with these loans.

Convertible Adjustable Rate Mortgages

Also called "CARMs". CARMs allow you to convert an ARM, an adjustable rate mortgage, to a fixed mortgage. CARMs can be great if interest rates are high now, but will probably be lower later. You can adjust to a fixed mortgage when the rates drop. That's the theory — but there's an element of gambling here. In the last few years, however, interest rates have been at historic lows, so the CARM has been less attractive.

FIRMs or "Fixed Interim Rate Mortgages"

FIRMs are generally 30-year mortgages that are fixed for a number of years, then convert to an ARM, or adjustable rate mortgage. Again, depending upon your personal financial situation and the interest rate market, FIRMs can be really good or really bad. Again, do a full evaluation of your financial picture before you opt for this type of mortgage.

GEMs or "Growing Equity Mortgages"

GEMs feature a gradually increasing payment, but all the payment increase goes to reduce your loan principal. GEMs allow you to pay mortgages off earlier, save tens of thousands in interest payments and build equity quickly. For instance, a 30-year GEM mortgage, depending on the interest rate, can usually be paid off in 18 years!

A Couple of Special Cautions

If you're thinking about touring model homes, be wary of the "fast close." Many states are chock full of wonderful new housing developments and subdivisions, and very few activities are as much fun as visiting them. But beware of developments that put you through a "fast track" sales system designed to get you to contract quickly to buy one of their homes.

Fast track systems are good for the seller's pocketbook—not your pocketbook. Some home builders and subdivisions literally won't let you tour a model home without going through the builder's sales office!

Some try to push you into signing a **"Builders Contract"** the first time you visit a model home. In many states, Builders Contracts are not standardized. For "just a few hundred dollars" these contracts legally bind you to buy a home and use the builder's mortgage company and agents.

Many "Fast Track" builders and subdivisions promise you "upgrades" if you sign with them on the spot. What should you do if this happens? Forget the upgrades! Don't ever enter into a relationship with a mortgage company or subdivision representative without comparing costs and services. We help you do that.

A Quick Tip: Be wary of "Arbitration Clauses" in home contracts. Binding Mandatory Arbitration (BMA) clauses say you must generally submit to binding mandatory arbitration to settle any difference with a builder or seller and you sign away your right to sue or use the regular court system for redress.

Voluntary arbitration clauses in certain circumstances can be good. But, in my opinion, they are generally bad for the consumer, particularly when it comes to homes. Read this article at www.educatorsiq.com/financial/arbitration.htm on Arbitration Clauses, if you want more details.

Be cautious of buying HUD foreclosure properties without doing your homework. These properties are almost always sold "as is", a very expensive phrase in the real estate world. Be extra cautious in checking out these homes.

Chapter 6: A Look At "Closing Costs"

"Closing Costs" are the expenses over and above your down payment that most buyers normally face when it comes time to close a loan. And these costs generally are not included in your loan amount. Closing costs are therefore usually "out-of-pocket" money. And though you can do your best to get the other side to pay the closing costs, you'd better understand what's included in that very loose term.

An advance warning: Be wary of television and Web ads from mortgage companies that promise "No closing costs and no points!" These mortgage companies typically build in bigger penalties and penalty charges into their contracts.

A Nice Note: We tell you here in advance exactly what Educators charges for these fees. Most lenders don't do that. And in some cases, we've negotiated you a cheaper fee for these costs. All members like that! Educators' closing cost fee is a flat $700* on ARMs and Balloon loans, much less than others. Below in "Lender's Fees" you'll see what the closing costs consist of.

Lender's Fees

Loan Origination Fee: A fee charged by lenders to procure your mortgage loan. Most lenders charge an origination fee because it is an important source of income for the lender and helps to cover operational costs. The industry standard is 1 percent of the loan amount; however, because this fee is set by the lender, it can vary. Educators doesn't charge this fee.

Discount Points: A fee charged to buy down the interest rate. When Educators quotes you a rate, it doesn't include any discount points unless you request them.

Appraisal Fee: An independent written opinion that identifies the property's market value. This document is generally required either by the lender's regulator or if the loans are to be sold by the lender into the secondary market, which most are. The fee can vary widely depending on the type and location of the property. For homes located in urban areas, this fee usually runs $250 - $350*. Educators requires an appraisal on all mortgage loans and only charges our actual cost for the appraisal. If you request it, we will always give you a copy of the appraisal.

Credit Report: A document summarizing the applicant's history of repaying debts. Credit reports usually cost $11 - $60*, depending on the source. A credit report is required for all mortgage loans. Educators does not charge a fee for credit reports on most loans.

Mortgage Broker Fees: Fees paid to individuals who produce mortgage loans for lenders, usually an independent contractor. Educators never charges a mortgage broker's fee.

Tax Related Service Fee: A fee required by lenders to cover the cost of annually researching tax records to insure that the borrower is current on their property tax payments. Educators only charges for our cost.

Processing Fee: (also sometimes known as an application fee) A one-time fee to process your mortgage loan application. Like the loan origination fee, this is a source of income for the lender that helps to offset operating costs. Educators charges $100*, which is much less than most lenders. If someone offers you a "no fee" or a lower fee than $100, they may be making up the difference by adding so-called "junk fees." Call us to compare the total cost for your mortgage.

Underwriting Fee: A fee charged by many lenders to review and approve the mortgage application. Educators only charges our cost for the underwriting.

Flood Certificate: A fee charged to obtain the government-required document that is used to determine whether the subject property is located in a flood plain. Educators only charges our cost for the document.

Items Lenders Require Paid in Advance

Pre-paid Interest: Mortgage loan interest is paid in arrears. This is daily interest paid from the day your loan closes and you take possession of the home until the end of the month. For example, your mortgage payment made on April 1 pays for interest accrued from March 1 to March 31 of the previous month.

Private Mortgage Insurance: (PMI) If your loan is more than 80 percent of the value of the property, lenders require this insurance. For certain loans, like FHA, this premium may be paid in a lump sum at closing. For most loans, this premium is paid monthly into your escrow account. Educators requires mortgage insurance if the loan is more than 80 percent of the property value.

Hazard Insurance Premiums: This is the annual premium for your homeowner's insurance.

Reserves Deposited With Lender

Hazard Insurance Premiums: In addition to the annual premium collected at closing, the lender may collect an amount equal to one or two months of hazard insurance as a buffer for any possible increases in premium. For the life of the loan, then, these funds are collected monthly along with the mortgage payment and held in an account until the lender receives, and pays, the bill for the hazard insurance.

Mortgage Insurance Premium Reserves, School Tax, Property Taxes, Assessment and Flood Insurance Reserves: The lender may collect an amount equal to one to three months of estimated taxes as a buffer for any possible increases in tax rates or property values. These funds are collected monthly along with the mortgage payment and held in an account until the lender receives, and pays the tax bill.

Title Charges

Escrow and Document Preparation Fees: These are fees collected by the title company or attorney handling the closing. The funds are collected and paid as part of the transaction. Educators only charges what our closer charges us and we negotiate the lowest possible fee for our members.

Notary Fees: A fee charged for having the signatures on all legal documents of the sale notarized. Educators does not charge a fee for a notary. Lots of people do.

Attorney or Closing Fees: Fees paid to an attorney or title insurance company to prepare the closing documents. Educators only charges you our cost and we negotiate the lowest possible fees.

Title Insurance: Provides insurance to owners of real estate to insure that they have clear title to the property they are buying, subject to any exceptions contained in the policy. Title insurance also insures the lender that they have an enforceable lien on the property, subject to any exceptions on the policy. Most lenders would never originate a mortgage without title insurance. The charge for title insurance is generally determined by each state's Department of Insurance.

Tax Deletion: Fee to pay the title companies to determine that all current and prior years' property taxes have been paid.

Government Recording and Transfer Fees

Recording Fees: Fee charged by the county to record the Mortgage/Deed of Trust or any other legal documents in the real estate loan transaction. Educators charges only our cost.

Additional Settlement Charges

Pest Inspection: Required for an FHA loan by the government or possibly by the underwriter/investor as a condition of the loan. Educators only charges our cost of the inspection.

Survey: Document outlining the exact dimensions of the property. Usually required for a purchase or anytime improvements (e.g. deck, fence, pool, etc.) have been done since the last survey.

**Any dollar amounts referenced in this chapter are accurate as of 11/2007 and are subject to change without notice.*

Chapter 7: The IQ Mortgage Guide In a Nutshell

This is a very short chapter, and it sums up the essence of our IQ member education program. In the very complex business of mortgages and buying and selling, trust is the most important quality of any mortgage company or any mortgage program. There are many great companies out there, and many good loans, too.

But in the real world, there are very few companies that have your vested interest at heart as much as we do: because our members like you own us, our stability depends on your stability. Because of that, we have a vested interest in saving you money and finding you the best answers to your questions.

What do you do now? Why not visit our website, http://ecu.mortgagewebcenter.com, or call (262) 886-5900 or (800) 236-5898!

Glossary

Learn all of these terms and you'll know more lingo than many people in the mortgage business! For terms that cover the whole home shopping and buying process go to our Mortgage website's A to Z Glossary, http://ecu.mortgagewebcenter.com/ResourceCenter/Glossary.asp?PID=85.

Adjustment Interval: How often the rate changes in an ARM (adjustable rate mortgage). *A Hint: Some mortgage companies adjust rates upward quickly, but adjust them downward very slowly — they make you wait for the benefits of lower rates, but charge you rate increases virtually on the spot. Avoid these folks.*

Appraisals or Appraised Value: What is something worth? In the mortgage world, only "certified" appraisals matter. Certified appraisals mean the appraiser has a license to provide this service.

ARM: (Adjustable Rate Mortgage) A loan with a payment that adjusts up and down based on interest changes. ARMs vary widely in their features and attractiveness. To quickly learn the good and bad about ARMs, see Adjustment Interval, Teaser Rates, Fully Indexed Rates, Negative Amortization and Deferred Interest.

Assessed Value: The value used by your local county tax assessor to determine property taxes. Assessed values are seldom the real value of a property and generally GO UP when a property is sold — since the new assessed value is generally determined by the new selling price. See Appraisals.

Assumable Mortgage: An assumable mortgage allows a buyer to "assume" your old mortgage, which can be an attractive if interest rates have gone up since you received your mortgage. Because Assumable Mortgages caused so many problems during the savings and loan scandal years ago, very few lenders offer them now.

Balloon Loan: These can be very dangerous. Balloon loans have lower payments than fixed loans, but end up with one whopping payment at the end. Occasionally, balloons can be valuable in certain circumstances.

Basis Point: A hundredth of one percent. Basis Points are generally used in the bond business to denote changes in the yield on bonds, which secure many mortgages. For instance, if the yield on a bond falls from 7 percent to 6.25 percent, it fell 75 basis points.

Bridge Loan: A loan which lets you borrow some of the equity tied up in your current home until that home sells. People generally use a bridge loan to help them buy a second house before their first house has sold. Bridge loans can be dangerous.

Buy-down: Generally, when you pay more in "points" to get a lower loan rate. See Points.

Cap: The minimum and maximum interest rates on an ARM. Believe it or not, a few loans have no maximum caps! Don't get one of those.

CARM: (Convertible Adjustable Rate Mortgage) A CARM allows you to convert an ARM to a fixed mortgage. CARMs are generally more expensive than an ARM — they usually start out higher than some other mortgages — and usually carry a conversion charge, which can run a percent or so. Use this loan with caution.

Cash Reserves: Enough money, after closing, to allow you to make a couple of mortgage payments and cover emergencies. Lenders require cash reserves.

Closing: The moment you've been waiting for! When the loan is funded and the deed is actually transferred between sellers and purchasers. Closing also means your mortgage payment is starting soon, if you're the buyer!

Closing Costs: Fees you pay to the lender for processing a mortgage loan and you pay to outside service providers. Amounts can vary enormously between lenders and **are not part of your down payment!** This guide gives you a rundown on closing costs.

COFI: (Cost of Funds Index) An index used by some mortgage companies to determine the rate on your adjustable mortgage.

Comparables: Other homes similar to a specific home in the same neighborhood. Comparables are used to determine the "market" value of a home.

Condominiums: Usually apartments or other dwellings that have adjoining walls or other common spaces. If you buy a condominium, you buy the space inside your walls and a portion of the common areas.

Contingencies: If you are a potential home buyer, read this carefully! These are conditions that have to be met before a contract can be enforced. If you are a buyer, for instance, make sure your purchase contract has a contingency clause that lets you out of the purchase if you can't get financing.

Conventional Mortgage: A mortgage not insured by a government agency.

Cooperatives: They may look like condominiums, but if you buy a cooperative you buy stock in the company that physically owns the property. Since cooperatives usually require board approval for you to buy, they can be harder to finance because they can be harder to resell.

Conforming Loans: Mortgages that follow Fannie Mae and Freddie Mac guidelines, particularly in their size. (See Fannie Mae, Freddie Mac.) For instance, if the maximum loan Fannie Mae will approve is for $322,700, any loan under $322,700 is a "conforming" loan. If it's over that amount, the loan is called, logically enough, a "non-conforming" loan, or a "Jumbo". Conforming loans generally have a lower interest rate than non-conforming loans.

Credit Reporting Services: Equifax, TransUnion, and Experian are the big three credit reporting agencies, also known as credit bureaus. They collect and evaluate credit information on you, and sell that information to third parties.

Deed: The actual document which transfers ownership at closing from the seller to the purchaser.

Deed of Trust: What you get in many instances rather than a mortgage. Deeds of Trust introduce a third party into the lending scenario; a "Trustee", who holds the property in trust. Deeds of Trust are not necessarily bad, but many make it easier for a mortgage company to foreclose on your mortgage.

Deferred Interest: A very dangerous situation, indeed. Deferred interest happens when you have an ARM which doesn't raise payments when interest rates go up, but instead simply adds the cost of the additional interest to your mortgage—as a consequence, your mortgage principal goes up even if you make your payments! Stay away from these.

Discount Points: What you pay at closing to get a lender to lower your interest rate. See Points.

Down Payment: The money you use to lower the amount due on a purchase. We always recommend you make bigger down payments, if you can.

Dual Agent: A real estate agent that represents both the seller and buyer in the same transaction. Generally speaking, be careful of "dual agent" transactions.

Escalation: You don't want to ever see this word in a letter from your lender. Escalation means the lender is demanding the total repayment of your mortgage, virtually always because you're way overdue in your payments. You're in default.

Escrow: Accounts established by neutral third parties to hold money for a seller or buyer. Your down payment or earnest money can go into an escrow account, also known as "**impound accounts**".

FHA Mortgage: When the Federal Housing Administration guarantees a loan by a lender. FHA mortgages were designed for persons with low income, generally, and for many first-time buyers. Because the FHA guarantees payment, FHA mortgages usually require a lower down payment and may have a lower interest rate. All FHA mortgages require mortgage insurance.

Fannie Mae: The government-sponsored organization that sets standards for mortgage loans, purchases mortgages and resells an interest in them to investors. Mortgages that follow Fannie Mae guidelines are usually cheaper. See also Freddie Mac.

FIRMs: (Fixed Interim Rate Mortgages) Generally 30-year mortgages that are fixed for a number of years then become ARMs. The adjustable portion of FIRMs is usually tied to the price of one-year treasury bills. For instance, FIRMs generally come in four loan periods—3, 5, 7, and 10 year fixed payments—and then variable payments for the remainder of the 30 years. These loans are also called "3/1", "5/1", "7/1" and "10/1" loans.

FSBO: Actually pronounced "Fizbow". A FSBO home sale simply means "For Sale By Owner." No real estate agent is involved.

Fixed Rate Mortgage: The interest rate for this loan remains unchanged throughout the length of the loan. Fixed rate mortgages generally cost more than the first years of an ARM.

Foreclosure: You don't want to ever go there! Foreclosure is when the lender legally seizes a property on which the mortgage is in default. Foreclosure happens when you get behind on your payments, can't honor your "escalation" clause (which says you have to pay off your mortgage right now) and are generally on your last leg, financially—and when you don't plan carefully.

WARNING: Some foreclosures happen quicker than others. For instance, if your mortgage company uses a "deed of trust", that company generally doesn't have to go to court to foreclose on your property. Rules vary on foreclosure state-to-state.

Freddie Mac: A cousin of Fannie Mae, Freddie Mac is the Federal Home Loan Mortgage Corporation. Its mission is to purchase loans and help the average home buyer.

Fully Indexed Rate: You really need to understand this term! Fully indexed rates tell you what an ARM is really going to cost you in interest. Some lenders quote you a promotion rate to get your business but gloss over the fact that the "full indexed" rate is usually dramatically higher. We won't let this happen to you.

GEMs: (Growing Equity Mortgages) GEMs are really that, if you can afford them. GEMs raise your payments after a certain number of years, but the entire payment increase goes to reduce your mortgage. GEMs allow you to pay off a 30-year mortgage in about 18 years.

Good Faith Estimate: An estimate of closing costs given to you at the time of application.

HELOCs: (Home Equity Lines of Credit) These can make sense, if you're careful with them. HELOCs allow most people to take advantage of tax laws to reduce their debt or finance other worthwhile things with the equity in their homes. But HELOCs also put you at risk of losing your home if you fall behind in payments.

Joint Tenancy: When two or more people have equal ownership of property.

Jumbo Loan: "Jumbo" loans are mortgages of a dollar value greater than the amount Fannie Mae and Freddie Mac will buy.

Lock-in Period: How long the lender will guarantee rates and terms. For instance, if a lender says their loan is a $100,000, 8 percent loan for 30 years, with a 30-day lock-in, this lender will only guarantee those terms for a month.

Loan Origination Fee: (also called POINTS) Charged by the lender to help cover its costs and profit.

LTV Ratio: (Loan to Value) The relationship of the property's market value to the total amount of the loan. Lenders just love it when you have a low LTV ratio.

Mortgagee: The lender.

Mortgagor: You.

Mortgagee Title Policy: A policy you provide which indemnifies the lender if there are any undisclosed liens or other snags concerning the property you're buying.

Negative Amortization: See Deferred Interest, but before you go there, **don't** go there! Stay away from negative amortization loans.

Non-conforming Loan: "Non-conforming" loans are loans that do not meet the loan guidelines provided by Fannie Mae and Freddie Mac. "Jumbo" loans are non-conforming because they exceed the maximum loan amount set by Fannie and Freddie for loans they will buy.

PMI: (Private Mortgage Insurance) You have to provide this when your loan has an LTV of 80 percent or higher. This insurance indemnifies the lender if you default and your property isn't worth what's owed on it.

Points: (also called Discount Points) A "point" is simply one percent of any loan. Points sound so small, but can be so large. If you're getting a $175,000 mortgage, for instance, a single "point" is $1,750. Lenders generally charge points if you want a lower interest rate. ***Question: How do you know if you should pay the points or pay a higher rate?*** Ask us!

Prepayment Penalties: A rotten proposition! Mortgages with prepayment penalties actually charge you money if you want to pay off a loan early. Generally speaking, you're crazy to get a loan with this provision and it is illegal in many states.

Pre-qualification: Many times, a worthless marketing ploy by lenders. Pre-qualifications aren't binding — and some lenders deliberately pre-qualify you for a large and cheap loan when they know you probably won't actually qualify for that loan when you apply for real. Forget pre-qualification! What you want is a PRE-APPROVED loan. Then you know to the penny what you can spend. ***A Tip: When you are pre-approved (as opposed to "pre-qualified") you are also in a much better position to negotiate with a seller — it's like you have cash in hand.***

Proration: The amount of taxes and other fees you pay at closing versus what amount the other side pays. It's a percentage of the total figure based on the time you will own the property in the year in which you purchase it.

Ratios: Two ratios really interest lenders: (1) How does the amount of your potential mortgage payment compare to your gross monthly income? Lenders generally don't want your payment over 28 percent of your income. (2) How does your total debt compare to your gross monthly income? Lenders generally don't want your total debt to be over 36 percent

Settlement Agent: The person in charge of actually closing the sale of a property.

Survey: A drawing that shows the boundaries of property. If there are easements, buildings or other improvements on the property, those areas also show on the survey.

Teaser Rates: These should be called "sucker rates". Many mortgage companies promote a cheap rate for the first few months to entice you, but don't exactly promote the whopping interest increase that follows. Don't pick a mortgage based on the teaser rate! See Fully Indexed Rates before you go any further!

VA LOAN: A loan guaranteed by the Veteran's Administration. VA loans are only made to veterans of the U.S. Armed Forces.

WARRANTY DEED: This document guarantees the genuineness of a piece of property when it comes to legal description and history.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How to Calculate Principal and Interest

Monthly Payments

You can calculate your monthly payments once you know how much you're going to borrow. We'll work through a couple of examples so you'll be able to figure your own very easily.

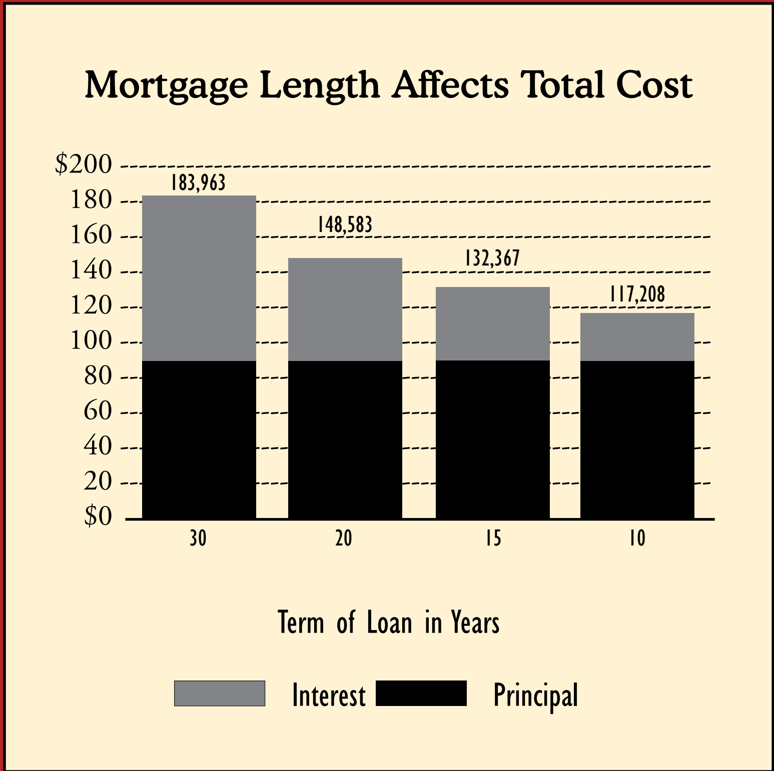
Remember, principal and interest are only part of your monthly mortgage payment, your total PITI amount. In the examples below, we are looking at only P & I.

Let's say you qualify for a mortgage of $90,000, payable over a 30-year term at 5.5 percent interest. Calculate your monthly payment as follows using the table on the next page:

- First, find 5.5 percent in the interest rate column. Go across that line to the 30-year column.
- Write down the amount of P & I per $1,000 ($5.68).
- Write down the amount of the loan in thousands (90).
- Multiply to get the P & I for $90,000 loan ($511.12).
- Likewise, if the mortgage amount was $95,000, you would multiply by 95.
- For $87,500, you'd multiply by 87.5, and so on.

If you opted for a mortgage term of 15 years, at 5.5 percent interest and again for $90,000, your calculations would look like this:

- Amount of P & I per $1,000 ($8.17)
- Amount of loan in thousands (90)
- P & I for $90,000 loan ($735.30)



Total Amount Paid

The monthly P & I payments for a $90,000 mortgage figured at 5.5 percent—are considerably higher for the 15-year mortgage ($735) than for a 30-year mortgage ($511).

But over the life of the loan, the total amount paid is considerably lower, as illustrated by the graph above.

If you can afford the higher monthly payment, it may be advantageous for you to consider the 15 year mortgage. On a $90,000 loan, you'd end up paying $51,596 less in interest.

Principal and Interest Table (Payment per $1,000 borrowed)

Interest Rate	10 Years	15 Years	20 Years	30 Years
5.000%	$10.61	$7.91	$6.61	$5.37
5.125	10.67	7.97	6.67	5.44
5.250	10.73	8.04	6.74	5.52
5.375	10.79	8.10	6.81	5.60
5.500	10.85	8.17	6.88	5.68
5.625	10.91	8.24	6.95	5.76
5.750	10.98	8.30	7.02	5.84
5.875	11.04	8.37	7.09	5.92
6.000	11.10	8.44	7.16	6.00
6.125	11.16	8.51	7.24	6.08
6.250	11.23	8.57	7.31	6.16
6.375	11.29	8.64	7.38	6.24
6.500	11.35	8.71	7.46	6.32
6.625	11.42	8.78	7.53	6.40
6.750	11.48	8.85	7.60	6.49
6.875	11.55	8.92	7.68	6.57
7.000	11.61	8.99	7.75	6.65
7.125	11.68	9.06	7.83	6.74
7.250	11.74	9.13	7.90	6.82
7.375	11.81	9.20	7.98	6.91
7.500	11.87	9.27	8.06	6.99
7.625	11.94	9.34	8.13	7.08
7.750	12.00	9.41	8.21	7.16
7.875	12.07	9.48	8.29	7.25
8.000	12.13	9.56	8.36	7.34
8.125	12.20	9.63	8.44	7.42
8.250	12.27	9.70	8.52	7.51
8.375	12.33	9.77	8.60	7.60
8.500	12.40	9.85	8.68	7.69
8.625	12.47	9.92	8.76	7.78
8.750	12.53	9.99	8.84	7.87
8.875	12.60	10.07	8.92	7.96
9.000	12.67	10.14	9.00	8.05
9.125	12.74	10.22	9.08	8.14
9.250	12.80	10.29	9.16	8.23
9.375	12.87	10.37	9.24	8.32
9.500	12.94	10.44	9.32	8.41
9.625	13.01	10.52	9.40	8.50
9.750	13.08	10.59	9.49	8.59
9.875	13.15	10.67	9.57	8.68
10.000	13.22	10.75	9.65	8.78
10.125	13.28	10.82	9.73	8.87
10.250	13.35	10.90	9.82	8.96
10.375	13.42	10.98	9.90	9.05
10.500	13.49	11.05	9.98	9.15
10.625	13.56	11.13	10.07	9.24
10.750	13.63	11.21	10.15	9.33
10.875	13.70	11.29	10.24	9.43
11.000	13.78	11.37	10.32	9.52