Think Hard Before Refinancing

What does refinancing mean?

Refinancing means getting a new mortgage loan on your house that pays off and takes the place of the loans you already have. Many banks and finance companies offer refinancing. Some advertise it on TV and the internet as a "magic" fix for people with debts because you can take out extra money to pay other bills. Others send offers in the mail, by e-mail or call you on the phone. They make it sound like you can solve your debt problems just by filling out a form.



Refinancing is tempting because it can get bill collectors and creditors off your back. But in many cases, it just digs you into a deeper hole. **Be careful!**

Refinancing often has hidden costs and fees, and other loan terms. Even well-known lenders sometimes make unfair refinancing deals. Do not sign a refinancing deal before talking to a trusted financial advisor.

But some loans, especially government insured loans like FHA and VA loans, offer refinancing programs at a lower cost with fewer credit requirements. If interest rates are low, it is a good idea to ask your lender or a housing counselor to see if one of these programs may be available to you.

You can get help from:

- The Minnesota Homeownership Center 651-659-9336 (in the metro) or 1-866-462-6466 (statewide) www.hocmn.org
- HUD Housing Counseling 1-800-569-4287

They can tell you about agencies near you that offer credit counseling, foreclosure prevention, and can help you decide if refinancing is a good idea for you.

Do Not Refinance Your House to Pay Other Bills

If you can't pay your mortgage, you will lose your house! This is much worse than anything that can happen to you for not paying other types of bills, like credit card bills, utility bills, car loans or hospital bills. Failing to pay these bills can't affect your house.

Secured vs. Unsecured Debt

A mortgage is a "secured" debt. Secured means that you put up "collateral." Collateral is property that the lender can take if you don't pay. Your house is the collateral, and you can lose it if you don't pay. See our fact sheet, *Your Rights in Foreclosure*.

Credit cards are usually unsecured. If you don't pay, they can sue you, get a judgment, and then take money from your wages or bank account. But they can't take your house! See our fact sheet, *Garnishment and Your Rights*.

The general rule is, **never turn unsecured debt into secured debt.** In other words, don't use a home mortgage to pay off your credit cards, medical bills, or other similar debts. If you are thinking about doing this, talk to a credit counselor first to see if it makes sense for you.

Do Not Let a Debt Collector Talk You into Refinancing



It is a debt collector's job to get their money any way they can. There are other ways to deal with them. See our fact sheet, *Your Debt Collection Rights*. If they want you to refinance your mortgage loan, just say NO!

Never Turn Your Car Loan into a Second Mortgage

If you can't pay on a regular car loan, only your car is repossessed. **Do not get a mortgage to pay off your car loan!!** If you take out a mortgage to pay off your car loan and then you fall behind on your mortgage, you will lose your house. It's better to lose your car than your home.

Don't Refinance at Higher Interest

The interest on a new loan must be lower than the interest rate you are paying now, or you lose money – lots of money.

A housing counselor can help to figure out if you should think about refinancing a loan that is less risky or more affordable in the long run. Talk to a housing counselor if:

- your current loan is an Adjustable Rate Mortgage (ARM) *(see next section)* **and** your interest rate is about to go higher than what you pay now, or
- a Balloon payment is coming due, or
- the loan you have now requires mortgage insurance.

For help in figuring out loan options call the Minnesota Homeownership Center at 651-659-9336 in the metro or 1-866-462-6466 outside the metro. You can also go to their website at www.hocmn.org.

Avoid Adjustable Rate Mortgages (ARMs)

Some companies try to sell you a mortgage with really low monthly payments for a short period of time, like 2 or 3 years. This can seem like a good deal because those early payments might be less than the amount you are paying on your current loan. BUT these loans are usually a trap! After the first couple of years, the payments "adjust" to a rate that is usually much higher than the beginning rate and often become more than you can afford.

Many loan officers tell you that you can just come back and get a new loan if the payments get too expensive. This is a common fraud in the mortgage industry. There is no guarantee that you can get a new loan when the payments increase. If your house goes down in value and is worth less than what you owe on your mortgage, it will be impossible for you to refinance. You are stuck with the high interest rate.

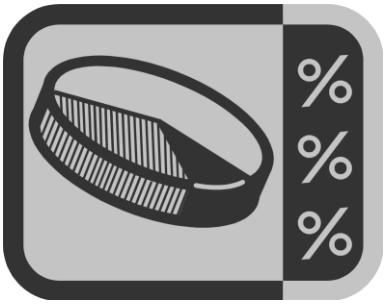
Even if you can get a new loan your principal balance will have increased several thousand dollars because of the fees that go along with 2 different refinancings.

If possible, get a fixed rate mortgage that lasts for 30 years. That way you know what the payments are for the entire time you have the loan.

Only Refinance If You Can Get a Lower Interest Rate and More Affordable Payments

Only think about refinancing if the new loan has a MUCH lower interest rate (at least 1 full percent) and your payments will be the same or less on the new loan.

NEVER do it if the refinance has a "balloon payment." A balloon means you make a low monthly payment for a certain amount of time, and then you have to pay the **whole** rest of the loan off in one payment. This explains why your payment is low. It's because you're not paying off the principal, only interest. The balloon payment can be thousands of dollars. If you don't have the money when it comes due, or can't get a new loan to cover it, you will lose your house.



Even if you can get a loan for it, it's not a good deal because you have to pay all the fees for refinancing all over again.

Modifying a mortgage is different than refinancing a mortgage

You may have also heard about programs for "loan modifications." A loan modification is not the same as a refinance. When you **modify** a loan, you agree to make changes in its terms. When you **refinance** a loan, you get a new loan that pays off the old one. Loan modifications can be a good way to save your home from foreclosure. They can also help make your payments more affordable.

Beware of people who offer to help you with a loan modification for a cost. Nonprofit organizations will help you with loan modifications at no cost to you.

It is usually up to your lender to decide if you can get a loan modification. But, you may have the right to certain kinds of loan modifications or other help to avoid foreclosure. It depends on the type of loan you have.

If you want help with a loan modification, call the Minnesota Homeownership Center at 651-659-9336 in the metro or 1-866-462-6466 outside the metro. You can also go to their website at www.hocmn.org.

Mortgage Relief Options

Many mortgage servicers offer other solutions besides refinance and modifications if you are having trouble paying your mortgage loan. For example, a servicer may allow you to "forbear" payments while you are experiencing a hardship. That means you can delay the monthly payment for a period of time if the servicer agrees.

It is important to understand the terms of the forbearance. This is especially true for when you have to start making monthly payments again- because you no longer have the hardship or because your lender is making you. Some lenders say you have to pay back all of the mortgage payments you skipped all at once. Or they may work out a repayment plan with you. This makes your new monthly payment more than your original payment until you catch up. Some servicers just add the missed payments to the end of your loan. Make sure you know the terms so you can plan!



For more information, talk to your mortgage servicers or call the Minnesota Homeownership Center for help at 651-659-9336 in the metro or 1-866-462-6466 outside the metro for more information. You can also go to their website at www.hocmn.org. There may be housing assistance programs that can help you make your payments.

Beware of Extra Charges

You have to pay certain fees to refinance your mortgage. Most refinancing deals have "points," broker's fees, title fees, and other charges, in addition to the interest. Make sure you know how much all of these are going to cost you ahead of time and ask questions about any charge you don't understand.

Beware of "extras" like mortgage insurance. Mortgage insurance makes your mortgage payments for you if you can't because you become disabled, unemployed or die. Mortgage insurance is a bad idea for most borrowers. But many lenders try to sneak it in or make it seem that you must buy it in order to get a loan. They make a lot of money from selling that insurance, and it doesn't do you much good.

Sometimes you don't have a choice and must pay for mortgage insurance as part of a mortgage. If so, be sure you understand how it works. You usually have the right to stop paying it after you have made payments for a long enough time. Talk to a homeownership counselor to find out if you have the right to stop paying for mortgage insurance.

The amount of fees you have to pay to get the loan should not be more than 2 or 3 percent of the loan amount. This includes all the costs that go with the new loan. The company you are borrowing money from has to give you papers that explain what all the charges are.

Watch Out for Prepayment Penalties on Your Old Mortgage

If you are thinking about refinancing a loan that you've had for only a few years, ask the loan officer if you have to pay a penalty to pay it off early. This is called a prepayment penalty.

Some lenders make exceptions to the prepayment penalty. For example, if you are refinancing with the same lender, they won't charge the penalty.

But some mortgages have a "prepayment penalty" clause. This kind of clause says that if you pay off the loan in the first 3 or 4 years you have to pay a penalty to the lender. This can be a lot of money. It is usually 2 or 3 months' worth of payments. Review your loan documents carefully.

If the penalty is longer than 4 years, or more than 2-3 months payment, talk to a lawyer, the penalty may not be legal.

When you are adding up the cost of refinancing, make sure to include any prepayment penalties in your total costs. Decide if it makes financial sense for you to refinance.

You Have 3 Days to Cancel Any Refinancing That Includes a Home Mortgage

You should get a "Notice of Right to Cancel" when you refinance. You can fill it out and return it within 3 days to un-do the whole thing. If you don't get that notice, and want to cancel the refinancing, write a letter saying, "I do not want to refinance. I want to cancel my loan." Sign and date it. Keep a copy. Hand-deliver it or send it by certified mail to the bank or finance company within 3 days of the closing. Save the certified mail receipt. Cancelling a mortgage loan can be complicated. Try to talk to a lawyer if you decide to cancel your loan.



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