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FDIC Consumer News

The New Climate for Mortgage Borrowers

Credit May Be Tougher to Get, But Good Loan Programs Are Still Available

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The New Climate for Mortgage Borrowers

Credit may be tougher to get, but good loan programs are still available. Even people having difficulty paying their mortgages have options for saving their homes from foreclosure.

You've probably read or heard about recent problems in the housing market — even if you haven't *directly* experienced declining home values, higher interest rates on mortgages or more stringent lending standards. But what does it all mean for you, especially if you're thinking about buying a new home or refinancing an existing loan?

FDIC Consumer News wants you to know that while some mortgages may be tougher to get than in the past, you shouldn't be discouraged — many good loan programs are still available to homeowners. The key is to be proactive — to understand your options and to put yourself in the best position to take advantage of them.

And, if you're facing the prospect of losing your home to foreclosure because of rising payments, you need to contact your lender or loan servicer as soon as possible to work out a reasonable solution. A loan servicer is a company that collects payments and performs other work for lenders, even including negotiating new payment plans with borrowers who are late or delinquent on their loan payments. "No one gains from foreclosure — not the lender nor, least of all, the homeowner," said FDIC Chairman Sheila C. Bair.

We've previously published tips to help mortgage borrowers, but here is a roundup of our latest suggestions. These ideas are for all homeowners because anyone can be affected by tighter credit standards or find themselves having trouble making their mortgage payments due to a job loss, health problems or other misfortune.

What's Happened and Why

First, a few words about how conditions have changed and why.

From about 2000 through 2005, interest rates were low and home values soared in many parts of the country. Many lenders met the strong demand for mortgages by promoting nontraditional mortgages (NTMs), which are characterized by low monthly payments in the early years in exchange for the deferred repayment of principal and/or interest. In addition, lenders offered "hybrid" adjustable-rate mortgages (ARMs), which have a low fixed-interest rate for the first two or three years, after which the interest rate periodically adjusts and mortgage payments generally increase.

Although NTMs (see examples on Page 4) and hybrid ARMs can be appropriate for some borrowers, such as people who are likely to have increasing income or to move in a few years, for many other consumers these loans can result in unaffordable monthly payments as the deferred principal becomes due and higher interest rates apply.

A large number of borrowers used NTMs or hybrid ARMs to buy houses they otherwise could not afford. It now appears that many of them may not have fully understood the risks of these products, and lenders did not adequately evaluate their ability to make higher payments over the life of the loan. Some lenders also provided NTMs and hybrid ARMs to "subprime" borrowers — individuals with damaged or limited credit histories — on the assumption that real estate prices would continue to rise and would protect the lenders if the borrowers defaulted on the loans.

Starting in 2006, however, home values began to flatten or even fall. As interest rates on NTMs and hybrid ARMs reset, borrowers faced significantly higher and even unaffordable monthly payments. Borrowers who had planned



to refinance to obtain lower payments found it difficult due to the declining housing market. Many people whose loans have reset, particularly those in the subprime market, have already missed payments, and that puts them at risk of losing their homes.

Now, lenders have tightened their standards for all borrowers. In general, they want to lend to applicants with a good credit record, the ability to make a reasonable downpayment, and fully-documented income to repay the loan. Lenders also are trying to better match borrowers with loans they can afford for the next 15 or 30 years, not just for the short term. So, how can mortgage borrowers find a loan that works for them?

If You're Looking for a New Mortgage or to Refinance

Try to raise your credit score in the months before you apply for a mortgage. Lenders look at a person's credit score, a numerical summary of a person's credit record, when deciding on loan applications. By aiming for the best possible score, you may be able to obtain a lower-cost loan and save hundreds each year in interest.

Protect your existing credit score by making all of your credit card and other bill payments on time. Beyond that, there are some quick things you can do to try to boost your credit score. One is to pay off much or all of what you owe on credit cards. “But don’t close any credit card accounts and don’t open any new ones before you get a mortgage, because either action could negatively affect your credit score,” added Mira Marshall, an FDIC Senior Policy Analyst.

Also, review your credit reports for incomplete or erroneous information and get it corrected. By federal law, you are entitled to one free copy of your credit report every year from each of the three nationwide credit bureaus. Go to www.AnnualCreditReport.com or call toll-free 1-877-322-8228 to order free credit reports or for more information. For more suggestions on improving your profile, start at the Federal Trade Commission’s Web site about credit reports and credit scoring at www.ftc.gov/bcp/menu/consumer/credit/reports.shtm.

If you’re thinking about buying a new house, consider modifying your strategy. Think about making a larger downpayment on a home if you can afford it and if doing so will help you qualify for a loan or significantly lower the cost of a mortgage. And if you realize that a home purchase doesn’t make financial sense at this time, consider waiting or looking at less expensive properties.

Contact several lenders and negotiate the best deal. Let them know you are comparison shopping. You may be able to negotiate the interest rate, closing costs or other terms, which could save you thousands of dollars.

Include your current bank and other local lenders in your search for the best mortgage. Recent studies show that financial institutions are more likely to make lower-cost home loans on properties in communities where they have branches. However,

you can also take advantage of the Internet to research mortgage products, comparison shop among hundreds of lenders, and apply for a loan from those same lenders. But remember that con artists operate on the Internet, too, so for guidance on whether a bank is legitimate, call the FDIC at 1-877-275-3342 or use Bank Find, our online directory of insured institutions, at www2.fdic.gov/idasp/main_bankfind.asp.

Compare fixed-rate and adjustable-rate loans, even if ARMs carry a lower initial interest rate. With a fixed-rate mortgage, you pay the lender the same, fixed interest rate over the life of the loan, which usually will be 30 years but could be 15 or 20 years. With an adjustable-rate loan, your interest rate may be fixed for a certain time period but later will periodically rise or fall based on a market index. Although early payments at “teaser rates” may be lower with an ARM, the interest costs later on can go up significantly. “Frequently, the fixed-rate loan is cheaper and safer in the long run,” said Janet Kincaid, FDIC Senior Consumer Affairs Officer.

Also carefully evaluate your ability to make payments throughout the life of a loan. “The mortgage loan originator should conduct a realistic assessment of your ability to repay, especially with

an ARM, including the highest possible payment under the terms of the loan,” said Victoria Pawelski, an FDIC Policy Analyst. “An unrealistic assessment based on a low, introductory payment can lead to payment shock and, for some people, a very costly foreclosure.”

Start by asking for a side-by-side comparison of what you would pay each month with both fixed- and adjustable-rate mortgages and assuming that the ARM’s interest rates will rise to their maximum levels. You’ll most likely see that after, say, three years, the ARM could start costing more than the fixed-rate option, and eventually could be far more expensive.

Real estate taxes and insurance can add significantly to your monthly payments, and they are likely to rise in the future, so also include those costs in your review. (Even though a lender may not require escrow payments for taxes and insurance as part of your mortgage, it’s important to factor those costs into your comparison.) Include any fees you would owe the lender and other service providers. Also find out if there will be prepayment penalties for paying off the loan early, because these can be very costly if you want to refinance or sell your home.

If you decide to go with an ARM, one way to protect against rising interest rates in the future is to add a

continued on next page

FDIC, Other Government Agencies Working to Help Borrowers

Banking and mortgage industry regulators, Congress and other government officials at the federal and state levels have been responding to the recent difficulties in the real estate market. “Working with our federal and state regulatory counterparts, insured institutions, the Congress, and other parties, we are eager to help find solutions for borrowers who have mortgages they cannot afford,” said FDIC Chairman Sheila C. Bair.

As *FDIC Consumer News* went to print, Congress was considering various legislative proposals relating to mortgage lending. Federal and state government banking regulators, including the FDIC, have been encouraging financial institutions to identify creditworthy borrowers who may have mortgages they cannot afford and to contact these customers and pursue appropriate strategies to avoid foreclosures. The Federal Housing Administration has announced new programs to help borrowers. And, state regulators are developing a new nationwide system for licensing mortgage lenders and brokers, and are working to enhance consumer protections.

“conversion option” that would allow you to switch to a fixed-rate mortgage in the future, for a set fee.

Be wary of a mortgage with payments that can increase substantially. “In the worst cases, people lose their homes when they take on mortgages they can’t afford,” said Sandra Thompson, Director of the FDIC’s Division of Supervision and Consumer Protection.

Examples of mortgages at risk of rising payments include:

- *Interest-only loans*, for which the borrower pays only the interest — not principal — for the first three, five or more years but then must either pay the loan off entirely or start making much higher payments to repay the principal. The potential risks are significant, especially if the interest rate has gone up and the consumer can’t make the new, higher payments.
- *“Payment option” ARMs*, meaning the borrower has several choices on how much to pay from one month to the next for a set time period. These ARMs may be appropriate for people whose monthly income fluctuates, but if they defer too much interest their costs will go up significantly (because they’ll be paying interest on a higher loan amount, perhaps for many years). “Borrowers risk defaulting on their loan if they can’t afford the higher payments and if they have problems switching to a better loan,” said Luke W. Reynolds, an FDIC Community Affairs Specialist.
- *Hybrid ARMs*, which as described on Page 2, charge a low fixed-interest rate in the early years and generally result in a higher payment thereafter. “These loans allow the consumer to place a bet on the direction of interest rates over the term of the loan, and it is very risky to take a bet when your home is on the line,” added Reynolds.

Take the time to document your sources of income as part of your mortgage application. Some lenders offer loans requiring little or no documentation of income, assets and

debts — they instead rely on a personal statement of the applicant’s financial resources. “These loans may be faster and more convenient, but they also may be more expensive,” said FDIC attorney Richard Foley. “You should always ask for the opportunity to document your financial resources because it could mean a lower interest rate or other cost savings.”

Protect against unfair and deceptive sales practices by working with a loan originator you know or who comes recommended by someone you trust. “Scrutinize any fee you’re being asked to pay a lender, broker or any other service provider,” warned Pawelski. “And don’t assume that every loan officer or mortgage broker will act solely in your best interest.”

At or near the top of the danger list are “predatory” home loans, which are expensive offers involving false statements or misleading sales tactics, usually to people in financial trouble and without regard for their ability to repay. Another questionable and potentially costly practice involves situations in which a lender gives extra compensation to employees or outside brokers for steering a borrower to a higher-priced mortgage, while claiming to be offering the best possible interest rate. There also have been instances of aggressive or misleading advertising intended to lure consumers into inappropriate adjustable-rate mortgages by, say, using the word “fixed” when the interest rate and payment could actually change during the life of the loan.

To find out if a company or sales representative has been the subject of consumer complaints, start by contacting your state government’s consumer protection or Attorney General’s office, which will be listed in your phone book or other directories. That state office also may be able to guide you to another state or federal government agency for additional information. (For a warning about frauds involving home loans and credit repair, see the box on the right.)

If You Can’t Make Your Mortgage Payment

Ask your lender or loan servicer about restructuring or refinancing your mortgage as soon as possible. Remember that if you miss payments and default on a mortgage, you could lose your home. The lender has the right to foreclose — to sell your home to raise money to pay off your debts. You could owe the lender more money if the home sale doesn’t cover your

Beware of Mortgage Scams

For most people, their home is their biggest purchase, and they’ll do practically anything to protect it. Unfortunately, that’s the reason why fraud artists target homeowners with high-cost and often illegal mortgage offers.

In one common example, con artists promise to erase a bad credit history or make easy loans to people with spotty credit histories. “Most of these offers involve exorbitant fees, come with hidden terms or never provide the promised money,” said Michael Benardo, manager of the FDIC’s Financial Crimes Section.

Mortgage foreclosure fraud is on the rise, with thieves posing as lenders or housing counselors offering to “help” people at risk of losing their homes to foreclosure. More than likely, the consumer pays high upfront fees for questionable services, and in the worst cases, thieves have tricked people into signing over ownership of their homes.

How can you avoid these types of fraud? “Try to deal only with businesses and other organizations you already know or that have been recommended,” said Benardo. He added that it’s safe to assume that any offer that sounds too good to be true, especially one from a stranger or an unfamiliar company, is probably fraudulent.

debt. You also could severely damage your credit record, which would make it more difficult to borrow money or get a job or insurance in the future.

Contact your lender or loan servicer as soon as you think you may not be able to make your loan payment and let the servicer know you are serious about addressing your debt problems and staying in your home. “The lender or servicer may be more willing to work with you on a solution if you show them that you are acting in good faith to improve your debt situation and address other problems,” said Donna Gambrell, Deputy Director of the FDIC’s Division of Supervision and Consumer Protection.

Also, don’t assume that your lender *wants* to take your home. For cost and other reasons, most lenders prefer to avoid foreclosing on homes and selling the properties. In addition, federal and state banking regulators, including the FDIC, have encouraged lenders and mortgage servicers to contact borrowers directly, assess their ability to repay, and pursue appropriate strategies to help creditworthy consumers avoid defaulting on a loan. These strategies may include modifying loan terms (perhaps by lowering the interest rate or extending the repayment period) and converting ARMs into fixed-rate loans. “Institutions are encouraged to work toward long-term sustainable and affordable payment obligations,” said FDIC Chairman Bair, who added, “Clearly, fixed-rate obligations provide the best opportunity for long-term stability.”

So if you get a call or letter from your lender or servicer regarding the upcoming reset of your loan, be sure to respond.

Before contacting your lender, consider getting help from a housing counselor. These are public and private organizations that, typically for no charge or a small fee, can provide advice and assistance on everything from buying a home to dealing with debt problems. The

latter includes help contacting and negotiating with lenders.

Be aware, however, that the FDIC and other government agencies have warned homeowners about costly credit-repair and mortgage-rescue scams (see Page 4). “For help working out a mortgage problem without paying significant fees and without fear of fraud, talking to a trained and certified foreclosure or housing counselor is a good choice,” said Lee Bowman, National Coordinator of Community Affairs at the FDIC. To find a reputable counselor in your area, contact the U.S. Department of Housing and Urban Development or the Homeownership Preservation Foundation (see below).

Be proactive in researching and exercising your consumer rights. Start by reviewing your mortgage contract and other handouts and

mailings from your lender. Solutions to your problems frequently can be found there, such as information about special programs the lender offers to help borrowers. Also check the Internet and other resources for your rights under state and federal housing laws. For example, if your mortgage is insured by the Federal Housing Administration (FHA), you may be eligible for special loan-modification programs and other assistance.

As a last resort, consider selling your home. If the sales price is high enough to pay off your mortgage, this will prevent the lender from foreclosing and will limit further damage to your credit record. But if the home sale won’t cover your debt, ask your mortgage lender or servicer about your options. Having a housing counselor or other experienced party negotiate on your behalf also may be helpful. 🏠

For More Help or Information on Home Loans

The FDIC publishes consumer information and has other resources that can help answer questions on home loans and related matters. Start at www.fdic.gov/quicklinks/consumers.html or call toll-free 1-877-275-3342. To send a question, e-mail us at www2.fdic.gov/starsmail or send a letter to the FDIC, Division of Supervision and Consumer Protection, 550 17th Street, NW, Washington, DC 20429-9990.

Other federal agencies also publish consumer information and respond to inquiries and complaints. A good place to start is www.mymoney.gov. Click on the “credit” section to read useful information from banking regulators, the Federal Trade Commission, the U.S. Department of Housing and Urban Development (HUD) and other government agencies on topics such as building a better credit record and shopping for a home loan.

If you are having problems paying your mortgage, HUD’s Web site at www.hud.gov/offices/hsg/sfh/econ/econ.cfm provides information to help borrowers avoid foreclosure and keep their homes. The FDIC and other financial regulators also are encouraging borrowers facing payment problems to talk to their lenders as soon as possible, and to consider getting help early from a reputable housing counselor by contacting HUD (1-800-569-4287 or www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm) or the Homeownership Preservation Foundation (1-888-995-4673 or www.995hope.org).

State and local government agencies also publish consumer information and help answer questions about home loans and lenders. Go to your state or local government’s Web site or call a consumer protection office listed in your phone book or other directories.

Military personnel and their families can find out about special loan assistance programs by checking with the Department of Veterans Affairs (online at www.homeloans.va.gov/index.htm) and their state government.

FDIC Insurance: You've Got Questions, We've Got Answers

Most of the calls and letters the FDIC receives from consumers — about 60 percent of them — are from people asking about their insurance coverage. Here are answers to some common questions that could be on *your* mind, too.

What are the FDIC's procedures for protecting depositors if a bank fails?

Federal law requires the FDIC to pay the insured deposits "as soon as possible" after an insured bank fails. In practice, the FDIC has paid insured deposits within a few days after a bank closes, usually the next business day. "The FDIC places a very high importance on ensuring that customers have quick and easy access to their insured deposits immediately after a bank fails," said Kathleen Nagle, Chief of the Deposit Insurance Section in the FDIC's Division of Supervision and Consumer Protection.

Most of the time, the FDIC makes payment to depositors by providing them with a new account at another insured bank. If arrangements cannot be made with another institution, the FDIC issues a check to each depositor.

The FDIC also is required by law to pay 100 percent of the insured deposits, including principal and interest, up to the federal insurance limits. The basic insurance coverage is \$100,000 per depositor. However, a customer may qualify for more than \$100,000 if there are accounts in different "ownership categories." For example, your share of any joint accounts at a bank are insured up to \$100,000 separately from accounts you hold in your name alone. Also, certain retirement deposits qualify for \$250,000 in coverage, not \$100,000.

If your bank fails and you have deposits over the limit, you may be able to recover some of your uninsured funds. The final payment is determined by how much the FDIC recovers in selling the failed

bank's assets, in a process that can take several years. "But remember," Nagle said, "the overwhelming majority of customers are within the insurance limit, and all deposits under the limit are always paid quickly and in full."

What happens to my FDIC coverage if I have accounts at two different banks that merge and the combined funds exceed the insurance limit?

When two institutions merge, the FDIC provides a "grace period" that temporarily protects depositors who had funds at both banks. In general, accounts at the two institutions *before* the merger would continue to be separately insured for six months *after* the merger—and longer for some certificates of deposit (CDs). When a CD is assumed by another bank as a result of a merger, it continues to be separately insured until the earliest maturity date after the end of the six-month period. "The grace period is intended to give customers an opportunity to restructure their accounts if the merger results in deposits that would exceed the insurance limit," explained Kate Spears, an FDIC Senior Consumer Affairs Specialist.

How can I be sure that deposits I send to an Internet bank are FDIC-insured?

Deposits placed with an FDIC-insured Internet bank are protected the same as deposits at a traditional bank, but you need to know who you are dealing with. First, not all financial institutions on the Internet are insured by the FDIC. Also, con artists set up Web sites that can look like those for real banks, mostly to trick consumers into divulging personal financial information.

If you are not familiar with an online bank, you'll want to confirm the correct URL for the institution's Web site, so that you're not visiting a copycat site. You can look up a bank's main URL using the FDIC's



Institution Directory system, at www2.fdic.gov/idasp.

Also, a bank can have one name that it uses for its traditional operations in branches and a different name that it uses for marketing on the Internet. It is important to determine the official name of the bank operating online — to confirm that it is FDIC-insured and to make sure you are not doubling up accounts at the same bank. Depositors who are confused about the true identity of a bank soliciting business on the Internet could inadvertently exceed the federal insurance limit by, say, having a \$50,000 CD at an Internet bank without realizing that it's a division of another bank where the consumer already has \$75,000 on deposit. In that case, the funds would be combined and would exceed the FDIC limit by \$25,000.

Continue your research by contacting the bank using information on the bank's Web site (provided by our online directory of institutions above) or some other independent source. You also may contact the FDIC for additional guidance. "We are happy to confirm the insured status of any bank or, when possible, help determine what trade name a bank may be operating under," said Spears. Start at our Bank Find page on the Internet at www2.fdic.gov/idasp/main_bankfind.asp, or call the FDIC toll-free at 1-877-275-3342.

For more help or information on FDIC insurance, start at www.fdic.gov or call the phone number above. ■

Timely Tips for Tax Season

FDIC Consumer News doesn't give tax advice, but we do occasionally have suggestions for you to consider or discuss with your tax advisor. Here is our latest collection of tips.

Have your tax refund direct deposited into your bank account.

"The benefits include receiving your tax refund faster and knowing that your refund check will be safe and not lost or stolen," said Luke W. Reynolds, an FDIC Community Affairs Specialist. "Direct deposit also provides an easy way to save part of your tax refund, because as they say, 'what you can't see you can't spend.'" Taxpayers also have the flexibility to directly deposit their tax refund in up to three different accounts at three different U.S. financial institutions.

If you need cash and you can't wait for your tax refund, carefully consider your options and costs. In particular, "refund anticipation loans" arranged by tax preparers for people who file their returns electronically, will get you cash in just a day or two, and the loan will be paid back with your tax refund, but the costs are comparable to very high interest rates. Also remember that people who file their returns electronically using the IRS "e-file" service can receive refunds in two weeks or less.

Make good use of your refund.

Consider paying down or paying off your loans and other bills, starting with the ones that charge the highest interest rates on unpaid balances. Start or add to an existing savings account. Or, fund a retirement account or college savings plan.

You can pay your tax bill using your credit or debit card but beware of the costs. Your financial institution may offer small incentives — such as miles, points, cash back or other rewards for using your card — but factor in the processing fee, which can be substantial, especially for credit cards. Other costs also may apply, such as interest if you don't pay your

card balance in full by the due date, and overdraft fees if your debit card withdrawal exceeds your account balance.

You can have your payment withdrawn electronically from your bank account. This service adds speed and convenience. You can also file your tax return early and set the payment withdrawal for a specific date, such as April 15. Ask your financial institution about any fees it may impose. But make sure you have enough funds in your account when the payment is to be made.

If you need to borrow money to pay your taxes, you have several choices but all come with fees and costs.

The cheapest way to pay your tax bill is to tap your bank account. But if you must borrow the money, options include bank loans, an IRS monthly installment plan and your credit card. "Using a home equity line of credit may be an option, but remember that you could lose your home if you are unable to make the payments," added Reynolds.

Take advantage of free tax preparation services. One IRS program that the FDIC is helping to promote is the Volunteer Income Tax Assistance (VITA) program, which provides free tax-preparation help to low- and moderate-income taxpayers at various locations. "Some VITA sites even have representatives from banks or other organizations who can assist in other ways, including opening a bank account or obtaining a credit report," said Cathy Davis, an FDIC Community Affairs Specialist and a VITA tax-preparation volunteer.

Another IRS program is "Free File," which allows taxpayers who earn \$54,000 or less (for returns to be filed during 2008) to prepare and file their federal taxes for free through the IRS Web site.

For more help or information, go to the IRS Web site at www.irs.gov or consult a tax advisor. 🏠

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For More Information from the FDIC

Go to www.fdic.gov or call toll-free 1-877-ASK-FDIC—that's 1-877-275-3342 — Monday through Friday 8:00 a.m. to 8:00 p.m., Eastern Time.


What's New on the Net

Here's a look at new Web sites that can help you manage and protect your money:

Avoid fake check scams: The Alliance for Consumer Fraud Awareness, a coalition of consumer and business organizations and the U.S. Postal Inspection Service, has created an interactive Web site at www.fakechecks.org with tips for avoiding check scams. The site features online videos and tests for consumers. For years, the FDIC has been doing its part to warn consumers about fake check scams by publishing informative articles in back issues of *FDIC Consumer News* at www.fdic.gov/consumernews.

Defend against identity theft: The federal government's Identity Theft Task Force, of which the FDIC is a member, has launched a new Web site at www.idtheft.gov to help consumers spot and stop ID theft. For more

guidance from the FDIC, see back issues of *FDIC Consumer News*.

Use an interactive calculator: Mymoney.gov, the federal government's one-stop source for financial education resources, now has interactive calculators you can use to help save for retirement, prepare for college expenses, buy a home, compare monthly payments for fixed- and adjustable-rate mortgages, and determine the current value of U.S. Savings Bonds. Find these calculators at www.mymoney.gov/calculators.shtml. Also remember that the FDIC has an interactive, online calculator that helps consumers determine the insurance coverage on their deposit accounts at an FDIC-insured institution. To access our Electronic Deposit Insurance Estimator, go to www.fdic.gov/deposit/deposits/index.html. 

New Law to Reduce Student Loan Costs

On September 27, President Bush signed a new law intended to make a college education more affordable for low- and middle-income families by making changes in federal student loan programs.

One provision of the College Cost Reduction and Access Act would gradually cut in half the interest rates on subsidized Stafford loans during the next five years. Another new program, to start in 2009, will give eligible borrowers (based on their income or a financial hardship) more flexibility when making loan repayments.

Look for details in the coming months at www.students.gov, a U.S. government Web site for college students and their families.