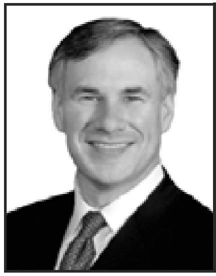

KNOW THE FACTS ABOUT "EXOTIC" MORTGAGES

by Texas Attorney General Greg Abbott

THE TEXAS REAL ESTATE MARKET has been booming in recent years. Over the past two decades millions of people have moved to the Lone Star State and, along with this growth, we have seen a steady rise in housing prices.

Many home buyers trying to keep up with an ever-changing market are turning to what at first appear to be attractive loans with very low monthly payments. Virtually anyone who surfs the Internet has seen banner and pop-up ads touting enticing offers, such as "$350,000 mortgage for $750 a month."

These offers, also known as "exotic" mortgages, might be the solution for some consumers, such as those who want the convenience of low payments initially and can afford substantially higher ones in the long run. But for those who are not fully aware of the terms, they could quickly find themselves in a bind.

Most of these low-ball offers are for interest-only loans. In the example above, the $750 a month payment will likely serve to simply pay off the interest that is accumulating, and that's assuming that the loan was extended with a very low interest rate (exotic mortgages sometimes have starting rates as low as one percent). However, consumers can rest assured that the low rates are for a limited amount of time. After a few payments, they rise to prevailing market offerings, based on the consumer's credit score and other factors.

If interest rises then the $750 monthly payment will serve to pay off only part of the interest, and still does not touch the principal of the loan. The unpaid interest usually becomes part of the mortgage itself. In time, the mortgage grows, and it is likely that after a couple of years of making low payments, these will be adjusted to reflect the rising interest and the growing mortgage. That rise could be substantial, doubling or even tripling payments. Unless the consumer begins to make payments that cover the accumulating interest and pay off the principal, they can find themselves in a cycle of accumulating debt. This also means that they will likely not build equity, the difference between the value of the home and how much is still owed on the mortgage, which will make it very difficult for them to sell the home.

To put it in perspective, for most 30 year mortgages with a reasonable interest rate, the monthly payments, including insurance and property taxes, equal about one percent of the value of the home. That means that for a $350,000 home, that payment would be somewhere around $3,500 a month. So it underscores that offering that size loan for only $750 a month is simply unsustainable in the long run.

Consumers need to be well aware of these facts before they sign a mortgage. The terms of mortgages vary greatly, and consumers owe it to themselves and their families to research all options available to them and to do a realistic self-assessment about what they can afford.

Offers for very low mortgage payments simply last for a short time. As with any loan, lenders will want to recoup the loan and make a profit. By careful research and planning, consumers can make a choice they can afford in the long run.

Buyers should not be distracted by fabulous sounding offers of low monthly payments. The consumer should know up front the total cost of the loan, the interest rate (and whether it will be variable or fixed), the potential rise in future payments, the length of the loan, how much principal they can expect to pay down each month, and similar factors. Purchase contracts are often complex and there are many variables to consider.

If you are in the market for a home, you would do well to consult with an independent professional, such as an attorney or licensed real estate expert, to guide you through the process and explain, in detail, the terms you are being offered and their long-term impact.