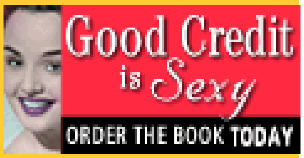

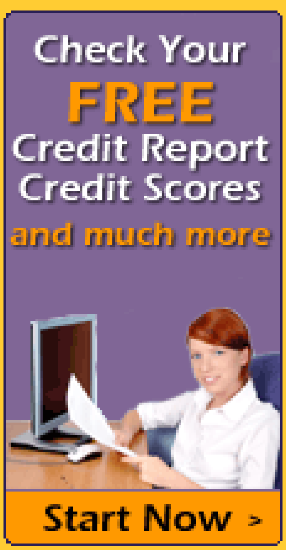

Mortgage Loans - secret methods that drive up the cost of your home purchase or refinance.

There are an enormous amount of fees associated with doing a loan. Most of them are fees that the loan officer and mortgage company cannot control, and are a part of every loan. In the case of the rest of the loan fees, the loan officer is in complete control of how much they will make off of a loan. Unfortunately, the typical consumer is unaware of these costs because they are hidden (legally so) in the loan paperwork and closing documents. However, laws are in the process of being drafted to correct this outright thievery.

In order to understand how a mortgage company makes money on a loan, you first need to understand which of these costs are profitable for the mortgage company. You can read our article on the real costs of doing a loan.

Fees Which Profit the Mortgage Company

The following fees determine the profit on the loan. They are completely under the control of the loan officer or mortgage broker. There is no standard for these fees; the unscrupulous loan officer will try and make as much as possible from you with these fees. After being in the loan business, I watched loan officers gouging their clients every day. It is a rampant, common occurrence. Most loan officers are not paid a salary, they are paid through commissions from every loan they originate that closes. This puts the pressure on them to make as much money as possible, wherever possible. Loan officers typically split the profits (usually 50/50) for each loan with the company for which they work. Therefore, every dollar they can squeeze out of you is 50 cents into their pocket. To originate a loan, the loan officer merely gets a client to fill out a loan application.

- Origination or Application Fees: These are fees for processing the mortgage application and may be a flat fee or a percentage of the mortgage. They usually are equal to one point. In fact, they are just a point called by a fancy name so the loan officer can charge more for the loan.
- Points: A point is equal to 1% of the amount borrowed. For example, one point on a loan amount of $50,000.00 is $500.00 dollars. Points can be payable when the loan is approved (before closing) or at closing. For FHA and VA mortgages, the seller-not the buyer-must pay the points. Even if you are not using an FHA or VA mortgage, you may want to negotiate points in the purchase offer. Some lenders will let you finance points, adding this cost to the mortgage, which will increase your interest costs. If you pay the points up front, they are deductible from your income taxes in the year they are paid. Different deductibility rules apply to second homes.
- Application Fees: Application fees are non-refundable and 100% pure profit for the mortgage broker. Walk out if they ask for an application fee up front. The only exception to this rule is if you have tough credit. In this case, the loan officer will have to do a lot of work before he can tell if your loan will go through. Time is

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money and he will want to be paid for this effort. If your loan gets denied without an application fee up front, the loan officer has put in a lot of hours for nothing.

- Points "On the Back": These are fees and commissions earned by the mortgage broker by selling you a loan whose interest rate is above the going rate. More about this later in this chapter.

The "normal fees" in the industry are an origination fee (1 "point") plus one additional point. Some brokers have a limit on how much a loan officer can charge in fees-the loan application fee, the origination fee, and the points, but not all. However, there is no absolute hard and fast rules.

Getting Points on the Back

Also known as "yield-spread fees", points on the back are one of the ways a loan officer makes more funds available to the total loan "kitty." It is essentially a "kick-back" from the mortgage bank the loan officer is buying the loan from, earned by selling a customer a loan at an interest rate that is above the going rate.

Each day, loan officers receive rates from banks for all of their loan programs. Listed for each program is the "par interest rate." The par interest rate is the interest rate at which the broker does not have to pay a fee to "buy" the loan and then sell it to you, nor does he receive a commission for selling you the loan at this rate. You might say that the par rate is "loan equilibrium." Table 3 shows an example of the types of rates a bank might publish to their subscribing mortgage companies every day.

EXAMPLE RATE SHEET ON A 30-YEAR LOAN

	6.5	6.75	7.0	7.25	7.5
15-day Lock	.50	.25	0.00	(.5)	(1.5)
30-day Lock	.75	.50	.25	0.00	(.25)
45-day Lock	1.50	.75	.50	.25	0.00
60-day Lock	2.50	1.00	.75	.50	.25

In the above example, the "par" value for a 15-day lock is 7.0%. The numbers in parentheses are the points returned to the loan proceeds as additional funds to offset the costs of the loan (or as a commission for loan officer). Why would anyone knowingly pay this higher rate? To get a "no-cost loan," which I will talk about next.

For example, if you wanted a $150,000.00 loan, but didn't have enough to cover the loan costs, you could bump up your interest rate to 7.5%, giving you: $150,000.00 x 1.5%/100 = $2,250.00.

This money will be credited to the loan proceeds at closing. What does this mean? It means that if your closing costs are $2,250.00, you won't have to lay out a dime to do the loan. Keep in mind, though, that if you are purchasing a home, you can't just up the interest rate to get your down payment. You must have enough money for the down payment.

And if you didn't know that the rate you were getting was higher than the par rate (meaning you paid full loan costs)? The loan officer gets that $2,250.00. Do some loan officers "forget" to tell you about this little loan surplus? Unfortunately, yes; it is one of the most profitable methods used by loan officers.

No-cost Loans

You've heard of those no-cost refinance loans? Forget it. There is no such thing. A broker must make money on every loan. Many well-intentioned loan officers honestly believe they are giving you a loan for free, but this simply is not the case.

In the example above, I showed you how you could get a loan at an interest rate above the par rate and get points on the back. The points on the back translate to extra funds available to pay the cost of the loan plus pay the loan officer a commission. So what's wrong with this? Nothing, but you are financing the "free cost" of the loan over the term of the loan (usually 30 years), which can double or triple the closing costs (by way of additional interest) as compared to pay the closing costs in cash.

How Do You Know if the Loan Officer is Jacking up Your Interest Rate?

It bears repeating that it is the loan officer who picks the interest rate he is going to sell you and, consequently, the commissions he will earn on the loan. If he is competing with another loan company to get your loan, he may not be greedy and not jack up the rate. But if you don't shop around, don't trust him to be honest. Some loan officers are completely up-front with you, but some aren't. Always shop around, especially if you have "A" credit. Some loan officers will charge you less if they know your loan will be a piece of cake to put through the system.

Take extra caution if you have less than stellar credit and must get a non-conforming loan, as these are typically the biggest target of shady loan officers. Desperate people have been known to have swallowed higher interest rates and 5 points in fees. This definitely is gouging.

The coming legislation?

The Washington Post stated in an article titled *Mortgage Brokers Likely to Disclose Fees Under New U.S. Guidelines (Oct 13, 2001)* that "An estimated 150 class-action suits are now pending in federal courts around the country pitting groups of borrowers against lenders who paid yield-spread fees to brokers". If plaintiffs, numbering 30,000 in one lawsuit alone, are victorious, the the potential settlement cost is quoted by the *Post* to be $135 million. Naturally, as such costs could put a good percentage lenders out of business, many are asking for better clarification by Housing and Urban Development (HUD) as protection.

HUD is in the process of recommending new legislation governing the home-buying process. In a press release issued on October 15, 2001, HUD's Housing Secretary Mel Martinez stated some of the key goals of the new legislation:

- **Full, upfront disclosure of all costs associated with obtaining a home loan in understandable terms prior to the payment of non-refundable fees.** Full disclosure would be a description of the specific services to be performed by the broker, a statement of whether the broker is acting as an agent for the borrower, and the amount of the total compensation to the broker, including any yield spread premium paid by a lender. In addition, HUD believes that the broker should explain the various loan options. The borrower should be informed that he or she may pay higher upfront costs for a mortgage with a lower interest rate, or conversely pay a higher interest rate in return for lower upfront costs. In the latter case, the broker may be receiving a yield spread premium.

- **Clarification of Yield Spread Premiums** - payments made by lenders for loans with higher interest rates. HUD's statement of policy says that yield spread premiums are legal if the broker actually performs services for the homebuyer, and if the total compensation the broker receives is reasonably related to the total value of the services the broker performs. Disclosure is especially important when borrowers may be paying yield spread premiums. Borrowers should know as early as possible what their settlement costs will be, so that they can shop for the best option.

- **Clarification of current HUD policy that states that consumer payments are not legal if they are overcharges, or if no service is provided.** HUD is restating and clarifying its policy that excessive and unreasonable fees are illegal under RESPA because they are unreasonable and not a payment for a bona fide service.

  The new policy will make clear that it is illegal for a settlement service provider to mark-up fees when it is making a payment to another settlement service provider, unless it provides additional value to the homebuyer in the process, or when a provider does no work for the fee and charges an unreasonable amount.

- **Expansion of RESPA enforcement.** Last year, HUD fielded more than 900 RESPA-related complaints, approximately one-third involving kickbacks and other questionable payments.

Currently, these measure are not enforceable by law, and are just guidelines. You can do your part and lobby your local government representative.

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