FINANCING

Watch for too-high rates, balloons and other red flags when loan shopping

BY DANA DRATCH
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There are a number of ways to recognize when a loan is not in your best interest. Read before you sign.

If your credit is damaged but you need cash, you might be tempted to accept a loan without worrying too much about the terms. But some conditions and clauses should make you reconsider your options.

"There are some extremely abusive, one-sided contract terms consumers sign because they think that's what they have to do to get the money," said Jean Ann Fox, director of consumer protection for the Consumer Federation of America. But often you can find a better deal if you shop around.

Here are some loan conditions that should make you think twice:

Money upfront

"Money upfront is a really bad sign," said Fritz Elmendorf, vice president of communications for the Consumer Bankers Association, a financial services trade group.

One nominal application fee is fine, he said. But the point of a loan is that they are supposed to be giving you money, not the other way around.

Changing interest rate

An adjustable-rate mortgage can be a good thing for some borrowers. But it should be a trade-off. In return for accepting a little uncertainty, the borrower gets favorable terms, like a lower rate. Too many times in the subprime market, borrowers are saddled with adjustable-rate mortgages simply as the cost of getting a loan, said Michael Stegman, professor of public policy and director of the Center for Community Capitalism at The University of North Carolina at Chapel Hill. If you have a rate that can change, you have to ask some questions.

"You want to know what is the worst-case scenario, not best," said Norma Garcia, senior attorney with Consumers Union. "What's the worst this can get? Will that be OK?"

Realize that a changing rate makes the loan a much riskier proposition for you. In a recent study of subprime mortgage refinance loans, ARM features boosted the chances of foreclosure by 49 percent, Stegman said.

Balloon payment

"The ideal is: Don't have any balloon payments," said John Taylor, president and CEO of National Community Reinvestment Coalition, a trade association of community groups. The worst scenario: The balloon is due early in the loan.

"It makes a huge amount of money due right away, and most people in the subprime market really can't afford to do that. So for a lot of people, they end up losing everything."

In subprime mortgage refinance loans, borrowers with a balloon payment have a 46 percent greater chance of foreclosure, Stegman said.

Too much money

More is not always better. So raise the red flag if a lender is trying to talk you into a larger loan. Two red flags if your home is the collateral. If you have to borrow, take the least amount for the shortest time period with the lowest APR.

Excessive fees

"Some fees are truly legitimate," Garcia said. "Some are backdoor fees that don't appear in the disclosure."

What you want to watch out for is excessive or hidden fees. Add everything up yourself. The sum of the terms you shopped should equal what's in the loan documents. If it doesn't, you need to ask some questions.

"The title insurance policy should be something competitive," Taylor said.

And if you're refinancing, you should get a refinance rate on the policy — often half the cost, he said.

"In terms of points, you shouldn't pay more than 1 to 2 points even in subprime situations. You can find competitive subprimers who will make you loans at those rates."

Additional services you don't need

Some loans are bundled with insurance policies to pick up payments or pay off the loan if you die or become disabled. Assuming you want the coverage (and can't get it cheaper from your insurance company), the problem is that many times you pay for the entire policy upfront and it's rolled into the loan with interest, Taylor said. So if you refinance that 30-year mortgage after five years, you'll have paid for 25 years of insurance that you won't use and can't recoup. If you want the feature, look for a pay-as-you-go version.

A credit card that taps your home equity

You don't want to squander home equity on a thousand little everyday purchases, Garcia said. "That's a real scary prospect."

High interest rate

The difference between prime and subprime rates will vary with the length and type of loan. With a mortgage, 5 percent to 6 percent above prime and "it's time for the customer to look around and see if they can do better," said Allen Fishbein, director of housing and credit policy for Consumer Federation of America.

Even if your credit is bad, shop around and be sure to include a credit union and a bank that makes both prime and subprime loans on your list.

No minimum loan term

Often with a payday loan, the entire loan (interest and principal) is due very quickly, Fox said. That means the borrower will be borrowing again just to keep pace with the debt, creating a never-ending cycle.

Requires a valuable asset as collateral

It may seem obvious that car-title lenders and pawn shops are a gamble because you risk losing the item if you can't come up with cash you already don't have. But consumers think nothing of putting their houses on the same block with a home equity loan or line of credit.

"The worst are home equity second mortgage loans, all of the loans that are secured by the roof over your head," Fox said.

Binding mandatory arbitration clause

What is this? Before you sign for the loan, you forgo any rights to sue for any reason and instead agree to binding arbitration. The problem: Many consumer advocates believe that arbitrators' decisions tend to favor the lenders and deny borrowers the right to due process.

Some of the big lenders are moving away from arbitration clauses, Fishbein said. But they're still around in the subprime market.

"This should be freely entered into at the time of dispute, not as a condition for obtaining the loan," he said. "By agreeing to this provision if a dispute should arise, the table is tilted toward the lender."

Prepayment penalties

For the borrower, this fee "adds to the cost of credit," Fishbein said. Reason: If your financial situation or credit improves, you can't refinance your loan at a better rate.

"It's one of the features we find particularly bothersome in subprime loans," Fishbein said.

Some credit experts advise avoiding prepayment penalties altogether. Others caution that one year is fine. Still others recommend keeping it to three years or less.

Prepayment penalties also increase the odds of foreclosure, Stegman said. In his study of subprime refinance loans, consumers with prepayment penalties of less than three years had a 15 percent higher rate of foreclosure. With three years or more, the numbers went to 20 percent.

And make sure the loan doesn't use the Rule of 78 to calculate interest. It's an antiquated method and "a hidden prepayment penalty," Fox said. What you want to see instead: the word "actuarial." That means "you pay for credit for the actual length of time you use it," she said.

Balance transfer fees

"Depending on how much you're transferring, it can be a lot of money," Garcia said. "It's something that's really easy to overlook and can cost you hundreds of dollars."

The lender solicited you for the loan

Face it, you get the best terms when you shop around and compare. If you're just accepting what was offered, you probably could do better.

Teaser rates

Who are they teasing? The person whose name is on the bill. Read the fine print and go with a lender who's willing to give you a good rate and stick with it.

It comes with a free vacation

"If it's a product that's that good, you don't have to add something to make it attractive," Garcia said.

High pressure tactics

Are you being urged to sign immediately? "Don't do that," Garcia said. Instead, have a third party look through the paperwork. Some possible candidates: an accountant, lawyer or someone at your local bank (if they aren't making the loan). Or call a local credit counselor affiliated with the National Foundation for Credit Counseling or the Association of Independent Consumer Credit Counselors.

"If it's good today, it will be good tomorrow," Garcia said.

The lender is focused on your assets, not your income

Whether you're pledging your car title or your home equity, if you're a bad risk and the lender doesn't care, that should set off the warning bells.

"The biggest thing that would send me running: 'no job, bad credit, bankruptcy — no problem because you have equity in your home,'" Garcia said. "If you don't have income, you're going to default and you will be out of your home."

A slew of little red flags

You may be able to negotiate a couple of unfavorable terms. But if the contract is loaded with them, you might just want to walk. A multitude of bad loan terms in combination could create a financial disaster.

The most dangerous triumvirate: an adjustable rate, prepayment penalties and balloon payments.

"You really don't want to have these combinations of terms," Stegman said.

Not only are you setting up a financial risk, but you're also limiting your escape options.

Terms you don't understand

Loans have gotten a lot more complicated. And with the addition of concepts like interest-only loans, adjustable rates and negative amortization, you might feel like you need an economics degree just to shop around. The truth is you might be better off with a more standard loan.

"Borrowers have to be asking a lot more questions than they were before," Fishbein said.

Especially tricky: What's the payment, how often will that change and what's the worst that it could get? And if increases are capped, does that mean the lender will add payments to the end of the loan?

"You need to do the math," he said, "and ask a lot of questions."

REAL ESTATE WATCH

Buyers are gaining leverage in real estate market

Holden Lewis

Real Estate Watch

In many real estate markets during the last three years, sellers have wielded more power than buyers. That's still the case, but now buyers are choosier, homes are staying on the market longer and prices aren't rising as quickly as they once did.

"It's a seller's market transitioning to a buyer's market," said David Lereah, chief economist for the National Association of Realtors. Sellers are reluctant to drop their asking prices, but a lot of them might have to "because the buyers now have a little more control, a little more power."

Here are five tips for the homeowner who is selling in a market where buyers are gaining clout:

- First, prepare yourself mentally.

"The big thing is you've got to accept what the market is, and make the most of it," said Jeff Lyons, general manager of RealEstate.com. "It doesn't have anything to do with you personally; it has to do with the market."

He advises sellers not to expect an extension of the supersonic price appreciation that some markets saw in the last couple of years. As Lyons put it, you're just going to feel frustrated if you think, "last year, everyone's house was worth 20 percent more than the year before, so why isn't my house worth 20 percent more this year?"

Lyons added: "You're going to want to prepare to be flexible."

Luckily, you can be flexible on things besides price. The move-in date, for example.

"If it helps you sell more quickly by moving out earlier than you want, that's a good thing," Lyons said. "You never know what people might want to do to make it convenient for them. If the buyer wants something that isn't hard for you to give, that's something in your favor."

- Second, get ready for picky buyers. In a transition from a seller's to a buyer's market, buyers "become much more sensitive to things like dated light fixtures," said David Kerr, agent for ZipRealty's office in Oakland, Calif. Old-fashioned lights, stained carpets, scuffed hardwood floors, dripping sinks, torn window screens — most of us live with flaws in our homes that we intend to fix eventually. When you put your home on the market, that day has arrived.
- Third, educate yourself about your neighborhood's real estate market.

Perch yourself on the real estate grapevine by talking to neighbors and real estate agents about sales in your neighborhood. Do homes tend to sell for 2 percent over the listing price or 5 percent under or what? Was a house recently sold for a surprisingly low price? Maybe the owners sold it to their own kids, a young family without much money. That's a good piece of intel to have when a buyer tries to use that neighboring house's low sale price against you in negotiations.

Interview at least two, and preferably three or four, potential listing agents and ask them to prepare competitive market assessments.

"Have them walk through the information they used to come up with that estimate," Lyons recommended.

- Fourth, hire an inspector. Buyers often make the purchase offer contingent on the home passing an inspection to their satisfaction. Increasing numbers of sellers are hiring inspectors before they put their houses on the market.

An inspector is impartial.

"He'll be able to tell you if the roof needs work or small electrical things that need to be done or plumbing things," Kerr said. Once you have identified and fixed the problems, "it makes the house that much more attractive to a would-be buyer."

- Fifth, consider paying the buyer's discount points.

Let's say the buyer wants you to drop the price by 3 percent. You're firm on the price, but are willing to be flexible by working mojo with the buyer's interest rate and tax bill.

You offer to pay 3 discount points, lowering the buyer's mortgage rate roughly three-quarters of a percentage point. By paying the discount points instead of selling for less, you get your price, the agents get bigger commissions, and the buyer makes lower monthly payments and gets to deduct the points from income taxes.

That's right. You pay the discount points, but the buyer gets the tax deduction.

"It's a win-win-win-win deal," said Bob Walters, economist for Quicken Loans.

Kerr doubts that the time is right for offering discount points.

"The market hasn't gotten there yet," he said. When it becomes a pronounced buyer's market, or when mortgage rates rise a couple of percentage points, that will be prime time for sellers to pay discount points.

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HOME Q&A

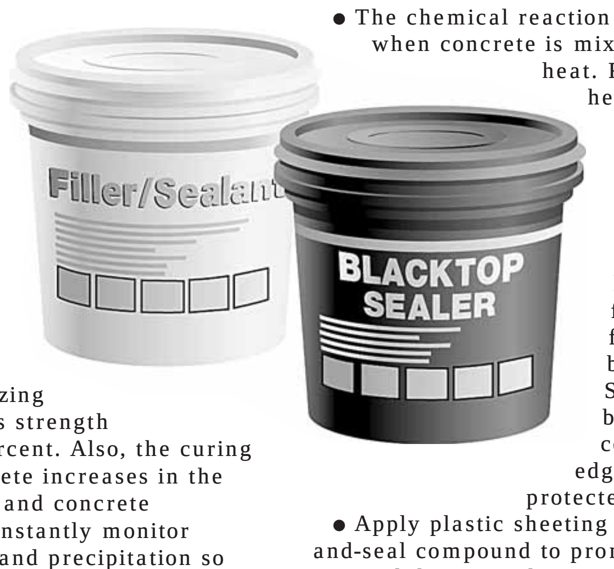
Cold concrete requires builder precautions

Builders Association of Greater Indianapolis

Q: What precautions do builders take with concrete in cold weather?

A: Many building materials perform differently in the cold than they do in balmy weather.

Since fresh concrete is affected when the mercury falls, contractors take special precautions while preparing foundations, footings, driveways, patios and porches in the winter.



Cold weather affects concrete construction in several ways. The lower the temperature, the longer it takes concrete to set up and gain strength. Newly poured concrete shouldn't be permitted to freeze, as freezing may reduce its strength by up to 50 percent. Also, the curing time for concrete increases in the cold. Builders and concrete contractors constantly monitor temperatures and precipitation so they can make any necessary accommodations.

For example, a concrete driveway shouldn't be placed on frozen ground because of the risk of heaving, an upward motion caused by frozen water in the soil. If the earth is frozen, contractors may wait for warmer weather, try to thaw the ground or excavate below the frost line. Digging deeper may lead not only to the extra step of adding fill before placing the concrete, but also to additional costs.

Contractors who use a little foresight and one or more of the following precautions can ensure that their concrete projects succeed when temperatures fall.

- Change the mix design of the concrete by including a higher proportion of cement, using Type III high-early-strength cement or adding chemical accelerators. These measures help the concrete set and gain strength more quickly.
- Use freeze-resistant concrete formulated for very cold conditions.
- The subgrade — the ground or fill — must be clear of snow and ice and cannot be frozen.
- The chemical reaction that occurs when concrete is mixed produces heat. Retain that heat by covering fresh concrete with insulating materials like fiberglass or foam blankets. Secure the blankets so corners and edges are protected.
- Apply plastic sheeting or a cure-and-seal compound to promote internal drying and proper curing of the concrete.
- Allow extra time for the concrete to cure before allowing it to bear vehicular weight or construction traffic.

Because concreting in the cold requires extra care and materials, winter construction costs more. In many cases, it's worth the expense to avoid delaying the work until temperatures climb. Of course, in extreme weather conditions, delays may be unavoidable.

— Scott Noel
Carmel Concrete