WHEN YOUR HOME IS ON THE LINE

More and more lenders are offering home equity lines of credit or second mortgage closed-end loans. These type of loans may offer a sizable amount of credit, available for use when and how you please and at an interest rate that is relatively low. Furthermore, under tax law —depending on your specific situation — you may be allowed to deduct the interest because the debt is secured by your home.

Before taking a second mortgage on your home, you should weigh carefully the costs against the benefits. Shop for the credit terms that best meet your borrowing needs without posing undue financial risk. Remember failure to repay could mean the loss of your home.

HOME EQUITY LINE OF CREDIT

A home equity line is a form of revolving credit in which your home serves as collateral. With a home equity line, you will be approved for a specific amount of credit. Your credit limit is the maximum amount you can borrow at any one time. The credit limit is usually determined by taking 75% of the value of your home and subtracting the amount you owe on your first mortgage.

SECOND MORTGAGE LOANS - CLOSED-END

Another type of second or junior mortgage is a closed-end loan. This traditional second mortgage loan provides you with a fixed amount of money repayable over a fixed period. This type of loan advances all funds at the time the loan is closed with no further advances. The loan can be interest following or precomputed. It is always preferable to have an interest following loan if you plan to pay the loan off before maturity.

You might consider a traditional second mortgage loan instead of a home equity line; if, for example, you need a set amount for a specific purpose, such as an addition to your home.

In deciding which type of loan best suits your needs, consider the costs under the two alternatives.

WHAT TO LOOK FOR ON ANY SECOND MORTGAGE LOAN

Look carefully at the credit agreement and examine the terms and conditions of various plans including the annual percentage rate (APR), the costs you'll pay to secure the loan, and prepayment penalties. The disclosed APR will not reflect the closing costs and other fees and charges, so you will need to compare these costs among lenders, as well as the APRs.

You cannot compare APRs of home equity lines to the traditional second mortgages since the APRs are figured differently. The APR for a traditional mortgage takes into account the interest rate charged plus points and other finance charges. The APR for a home equity line is based on the periodic interest rate alone. It does not include points or other charges. You can compare the closed-end "note" rate with the line of credit APR and their other charges.

REFINANCING YOUR PRESENT MORTGAGE

If you are a homeowner who was lucky enough to buy when mortgage rates were low, you may have no interest in refinancing your present loan. But perhaps you bought your home when rates were higher. Perhaps you have an adjustable-rate loan and would like to obtain different terms. Or want to draw on the equity built up in your home to get cash for a major purchase or for your children's education.

WOULD REFINANCING BE WORTHWHILE?

A general rule of thumb is that refinancing becomes worth your while if the current interest rate on your mortgage is at least 2 percentage points higher than the prevailing market rate. This figure is generally accepted as a safe margin when balancing the costs of refinancing a mortgage against the savings.

There are other considerations such as how long you plan to stay in the house. Most sources say that it takes at least three to five years to realize fully the savings from a lower interest rate, given the costs of refinancing.

COSTS OF SECOND MORTGAGE LOANS OR REFINANCING YOUR MORTGAGE

The fees described below are the charges that you are most likely to encounter.

Application Fee. This charge imposed by your lender covers the initial costs of processing your loan request and checking your credit.

Loan Origination Fees and Points. The origination fee is charged for the lender's work in evaluating and preparing your mortgage loan. Points are prepaid finance charges imposed by the lender at closing to increase the lender's yield beyond the stated interest rate on the mortgage note. One point equals one percent of the loan amount. For example, one point on a $75,000 loan would be $750. In some cases, the points you pay can be financed by adding them to the loan amount.

Other Closing Costs. Other closing costs are listed below with average costs:

Appraisal Fee	$ 75 to $300
Survey Costs	$150 to $400
Home Inspection Fees	$175 to $350
Lender's Attorney's Fees	$75 to $200
Title Search & Insurance	$450 to $600
Homeowner's Insurance	$300 to $600
Mortgage Insurance	(one year + 2 months premium depending on amount and type of loan)

Escrowed Funds. Funds sufficient to pay for taxes or insurance that are coming due shortly.

Prepayment Penalty. A prepayment penalty on your present mortgage could be the greatest deterrent to refinancing. The practice of charging money for an early pay-off of the existing mortgage loan varies and is a matter of the contractual provision on first lien mortgages. Prepayment penalties are forbidden on VA and some other types of loans. Second mortgage loans in Indiana cannot have a prepayment penalty imposed on loans refinanced by the same creditor, accounts paid by the proceeds of credit insurance, or if paid after three years.

You should be sure to look at the prepayment provisions on the mortgage loan you are taking out; especially if you plan to pay the mortgage off early.

IN CONCLUSION. . . .

A homeowner should plan on paying an average of 3 to 6 percent of the outstanding principal in refinancing costs or 3 to 10 percent on second mortgage loans plus any prepayment penalties. One way of saving on some of these costs is to check first with the lender who holds your current mortgage. The lender may be willing to waive some of the costs.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

- Answers to Credit Problems
- Applying for Credit
- At Home Shopping Rights
- Bankruptcy Facts
- Buried in Debt
- Car Financing Scams
- Charge Card Fraud
- Choosing A Credit Card
- Co-Signing
- Credit and Divorce
- Credit and Older Consumers
- Deep in Debt?
- Equal Credit Opportunity
- Fair Credit Reporting
- Fair Debt Collection
- Gold Cards
- Hang up on Fraud
- High Rate Mortgages
- Home Equity Credit Lines
- How to Avoid Bankruptcy
- Indiana Uniform Consumer Credit Code
- Look Before you Lease
- Mortgage Loans
- Repossession
- Reverse Mortgage Loans
- Rule of 78s – What is it?
- Scoring for Credit
- Shopping for Credit
- Using Credit Cards
- Variable Rate Credit
- What is a Budget?
- What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information.

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Second Mortgage Loans and Refinancing

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