

Watch Out for These Mortgage Mistakes

Many families today have more wealth tied up in the stock market than in their homes, but a home remains an important financial asset. That's why it pays -- sometimes big dollars -- to avoid some of the following mistakes involving the home mortgage.

Assuming you should have a mortgage. Most of the time you're financially better off owning a home than renting -- you can never pay off rent, employers and lenders like home owners, it's forced savings, there are tax advantages and so on. But sometimes it pays to rent if you plan to move in two or three years, find interest rates too high or expect home prices to decline in the near future.

Not understanding the different types of mortgages. A straight-forward 30-year fixed-rate mortgage may be just the ticket for you. Then again, an adjustable-rate mortgage (ARM) might make sense if you expect to live in the house only a few years or you need the lower first-year rates compared with a fixed-rate mortgage so you can afford to buy. Normally there is a discount for shorter-duration loans, especially 15-year ones.

Not shopping around for a mortgage lender. Amazingly, people shop for food bargains involving a few pennies, but don't bother to shop around for a mortgage lender that involves thousands -- potentially tens of thousands -- of dollars. Lenders can vary significantly in interest rates and fees. Ask your real estate agent, call around to lenders, or check the web.

Failing to get pre-approved for a mortgage. By having a mortgage pre-approved (versus merely "pre-qualified"), you have a better chance of the seller either coming down in price or accepting your bid over a buyer who is not pre-approved.

Assuming it's best to prepay. Putting in extra money toward the principal each month on a 30-year fixed rate mortgage, for example, might pay off the loan in 20 years and save thousands of dollars in interest. But there are several issues to consider before deciding, so you should talk them over with your Certified Financial Planner®.

From a financial standpoint, it might be better putting that extra money into investments likely to pay a higher return than the interest rate you're paying on your mortgage. For example, large-company stocks have historically averaged around 11% a year, while paying off a mortgage early would be equivalent to investing in an asset returning the mortgage rate -- say 8%. (Actually, a comparison should be made in after-tax dollars, since you receive a tax deduction for interest paid, which essentially lowers the interest rate you're paying.) On the other hand, there is no guarantee your stock investments will

return 11%, while paying off the mortgage early is a sure thing. Also, many people find it psychologically comforting to pay off their mortgage early.

Using biweekly mortgage plans. Some mortgage companies have plans in which homeowners make house payments every two weeks instead of once a month. At the end of the year, the homeowner has made the equivalent of an extra month's house payment, which cuts a 30-year mortgage down to 25 years. The problem is, the plans charge an up-front fee and a biweekly administration fee. If the company doesn't charge a prepayment fee, just write an extra month's rent each year and save the fees. For this reason we generally do not recommend this practice.

Continuing to pay private mortgage insurance. Homeowners who pay less than 20% down typically are required by the lender to pay for private mortgage insurance (PMI), which covers the lender in case of default. The federal Homeowners Protection Act now requires lenders to automatically terminate these policies once the loan balance declines to 78%. The Act was created because many homeowners continued to pay for PMI even when it wasn't needed. The problem for current homeowners, however, is that the Act generally applies to homes bought on or after July 29 of this year. If you've paid off at least 20% of your equity, ask your lender to drop the PMI.

Assuming it's not worth refinancing. Homeowners often think it's not worth refinancing unless they can drop their mortgage rate a couple of percentage points. Yet a lot depends on the tax bracket you're in, the size of the mortgage remaining, refinancing costs and so on. Run the numbers.