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When it Comes to Understanding your Loan Terms, the FTC is on Your

A recent study by real estate data company RealtyTrac revealed that foreclosures are still on the rise. In fact, they jumped up 19 percent in May compared with April and are up 90 percent over May 2006 figures! A large portion of these foreclosure filings seem to be coming from borrowers with unconventional adjustable rate mortgages (ARMs), including interest-only and pay option ARMs. Many of these people got into the housing market during the past several years when the industry was booming and credit lending standards were looser. Unfortunately, many also did not seem to fully understand the terms of their mortgages when they signed. Now that hundreds of thousands of ARM loans are resetting at higher interest rates with much higher monthly payments, many borrowers are finding themselves unable to cope with the payment shock, resulting in default and foreclosure.

While there may be limited options for those currently in the throes of this problem, federal agencies are working hard to prevent such a crisis from happening again. The Federal Trade Commission (FTC) for example, is trying to close the gap of misunderstanding about loan terms. The theory is that if borrowers understand their loans, like how much the monthly payment could increase in the future, and exactly how much they are agreeing to pay in loan fees, they will be more cautious about getting into risky loans, and they will be more prepared for the consequences if they do choose exotic loans.

With that in mind, the FTC recently conducted a survey regarding the disclosure forms that lenders have borrowers sign before they close on a home loan. The FTC has designed a new disclosure form aimed at helping consumers better understand the terms of their loans before signing. After testing disclosure forms on 819 people, and conducting 36 in-depth interviews, the FTC found that many people were confused by the current disclosure forms.

“Mortgage disclosures designed more than 30 years ago can be confusing even for simple loans, and they do not address the variety and complexity of today's mortgage products,” Deborah Platt Majoras, the FTC's chairman, said in a statement. “Mortgage disclosures alone won't prevent deceptive lending practices, but consumers who understand mortgage terms are less likely to fall victim to these practices.”

The new forms created by the FTC provided borrowers with a much better understanding of terms for loans like fixed rate mortgages, balloon payment loans, and interest-only loans. The study found that both prime and subprime (good and poor credit) borrowers were better able to understand more complicated loan terms with the new forms.

The FTC hopes that the new forms will be implemented and claims that they will cut down on deceptive lending practices and create better competition among lenders as borrowers' understanding of loan terms is clarified. This implementation may not take place for some time however. In the meantime, if you are applying for a home loan, if you are not comfortable with figuring out the mortgage terms yourself, be sure to bring in a financial advisor or trusted attorney to help spell out the fees and the conditions. Even when new forms are integrated into the lending world, consumers still need to take personal responsibility for understanding the terms of their mortgages.