

106 MORTGAGE SECRETS ALL BORROWERS MUST LEARN— But Lenders Don't Tell

Second Edition

GARY W. ELDRED, PhD



John Wiley & Sons, Inc.

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Preface to the Second Edition

During the past 10 to 12 months, the media have flooded us with news about the so-called mortgage meltdown, a doubling or tripling of delinquent mortgage loan payments, the dramatically increasing rate of property foreclosures, the tragic stories of people who now suffer payment shock, and more generally, the millions of borrowers who paid far more for their property loans than they would have paid had they shopped, compared, and negotiated wisely instead of merely relying on the supposed good faith of their loan representatives.

William Poole, president of the Federal Reserve Bank of St. Louis, was recently quoted in *The New York Times* (July 27, 2007) as saying, “Driven by the prospects of high fee income, mortgage originators have persuaded many borrowers to take out these [expensive and unsuitable] mortgages.” Or, more bluntly, disaffected borrower Jennifer Hintz says, “I feel we got totally screwed” (“Nightmare Mortgages,” *BusinessWeek*, September 11, 2006).

Isolated incidents? Hardly. The U.S. Congress and the attorneys general of more than a dozen states are holding hearings and conducting investigations that clearly reveal widespread fee gouging, unsuitable loan products, nondisclosures, deceptive advertising, bait-and-switch practices, and other malfeasance by loan reps and mortgage lenders.

So, it is within this context that my editor, Laurie Harting, suggested that we bring out an updated edition of *106 Mortgage Secrets All Borrowers Must Learn*. Although any reader of the first edition would have been forewarned against the abuses that are now coming to light, this new edition sets out in more detail how borrowers go wrong—plus, it emphasizes how to make financing property one of the the most rewarding transactions of your life.

When you learn how to loan shop with savvy, explore alternatives, and stay alert for ill-advised borrowing, the United States offers the best mortgage system in the world. Many loan reps will work diligently to help you own your own home and build wealth through investment real estate. These loan reps and lenders deserve fair compensation for their help.

Nevertheless, as a borrower, you must assume nothing. You must question intelligently; you must know how to distinguish the fake from the genuine. You must understand that maybe you shouldn't even use a lender to originate a new mortgage; rather, you might ferret out seller financing or an assumable mortgage (yes, contrary to popular belief, lenders still write a million or more assumable mortgages every year), or you might consider a "subject to," a wraparound, a lease option, or a blended-rate refi. Or you might snag a bargain through buying a foreclosure or a lender REO.

The first edition of *106 Mortgage Secrets* was widely praised by homebuyers, investors, and consumer advocates. It was often condemned by loan reps who want to keep you in the dark. One such reader trashed the book and claimed, "There are no secrets here; your lender has to tell you all of these things." The recent outpouring of media coverage firmly disposes of that nonsense. Lenders and loan reps—even those who display honesty and competence—try to get you to buy the product(s) they sell. Few, if any, will explain those many financing or buying opportunities that they do not offer.

That's where this new edition of *106 Mortgage Secrets* comes to the rescue. Unlike any other book on property financing, this new edition of *Mortgage Secrets* steers you away from those loan choices that will lose you money—and shows you how to find, structure, and negotiate the lowest-cost financing that leads you to maximize your ownership and wealth-building possibilities.

I wish you the best in your quest for property ownership. Should you discover questions, insights, or anecdotes that you would like to share with me, please give me a call at 352-336-1366 or visit my website, garyweldred.com.

Introduction: Use OPM to Achieve All That You Really Want

In this book, you will discover how to arrange the best deal when you finance your home or investment properties. But you'll gain much more than that. *Mortgage Secrets* goes beyond “the best loan for the lowest cost” type of discussion and shows how to achieve multiple objectives. For example, how many of these goals appeal to you?

- ◆ Own your own home?
- ◆ Trade up to a larger home?
- ◆ Refinance an existing property?
- ◆ Buy properties at bargain prices? Foreclosures? REOs?
- ◆ Strengthen your qualifying ratios?
- ◆ Overcome cash or credit problems? Boost your credit scores?
- ◆ Own a home or investment property that you think is priced beyond your means?
- ◆ Own rental properties that yield positive cash flows and high rates of appreciation?
- ◆ Reduce borrowing costs by tens of thousands of dollars?
- ◆ Buy property with little or no cash out of your own pocket?
- ◆ Avoid predatory loan reps, loan terms, and loan costs?
- ◆ Learn to live “on the house”?
- ◆ Build millions in wealth and enjoy a life of financial freedom?

Yes, in this book you will learn the best, the easiest, and the least costly ways to finance real estate. But you will gain much more than that. Most importantly, you will discover how to use credit (Other People's Money, or OPM) to create wealth. You will learn to think about money and financing in ways that will change your life. Before you borrow, you must always

answer these two questions: (1) Will this loan help build my net worth? Or, (2) might this loan diminish (or maybe destroy) my financial future?

Banks and finance companies want you indentured to them. Unless you resist, they will load you up with car loans, credit card loans, home equity loans, boat loans, vacation loans, and other types of monthly payments that zap your financial strength. Although such loans enrich the banks, they deep-six your ability to create a secure and prosperous future for your family and yourself.

So, read *Mortgage Secrets* to discover the best way to finance the properties you want to own. But also, think big. Let *Mortgage Secrets* guide you toward the financial goals that will bring about the life you would really like to live. To win the money game, outsmart the banks. Learn to cheaply borrow productive debt. Say no to high-cost consumer loans. Steer clear of consumer debt that swamps you in a quicksand of monthly payments.

Think of OPM not just as Other People's Money. Think of OPM as Our Productive Money. When you learn the secrets of leverage and productive borrowing, you learn the secrets of the millionaire mind. You learn the secrets of living well.



CHAPTER 1

Affordability Depends on You—Not a Lender

You’ve heard the advice, “Before you shop for a property, meet with a lender and get preapproved for a loan. The lender will tell you exactly how much you can afford to borrow.”

That advice seems right. Why pore over the menu at the Ritz Carlton when your budget says McDonald’s? But here’s the problem—and the opportunity.

SECRET # **1**

Affordability depends on you.

In the world of property finance—for homebuying and investing—the loan market offers thousands of lenders and hundreds of financing techniques. Plus, interest rates, closing costs, credit standards, and underwriting guidelines vary among lenders.

Read through the following list of 65 affordability techniques; these techniques only sample your loan alternatives. Because you enjoy a cornucopia of choices, no loan rep (or anyone else) can tell you exactly how much loan (or how much property) you can afford until they work through these and other possibilities. If one lender (or seller) says, “No,” you say “Next.”

Selected Sources and Techniques to Achieve Affordability

Accessory apartments

Adjustable rate mortgages

ARM assumptions

ARM hybrids

Balloon mortgages

Blanket mortgages

Buy a duplex, triplex, or quad (tenants pay mortgage)

City down payment assistance

Co-borrowers

Co-ownership

Co-signers

Community reinvestment loans

Compensating factors

Contract-for-deed

County down payment assistance

Create value/fixer-uppers

Employer-assisted mortgage plans

Energy efficient mortgages

FHA assumable w/qualifying

FHA Title 1 home improvement loans

FHA 203(b)

FHA 203(k)

FHA 203(b) mortgages

FHA 203(k) mortgages

Fannie Mae affordable mortgage programs

Fannie Mae Community Home-buyers programs

Fannie Mae Start-up Mortgage

Fannie 97

Financial fitness programs

Freddie Mac central city mortgage programs

Gift letters

Government grant money
Habitat for Humanity homes
Homebuyer counseling centers
Homebuyer seminars, fairs, classes
HUD/FHA foreclosures
HUD homes with easy financing
Interest rate buydowns
Interest rate buy-ups
Interest only mortgages
Lease-options/lease purchase
Lease-purchase agreements
Mortgage credit certificates (MCCs)
New home builder finance plans
Not-for-profit grant money
Option ARMs
Owner will carry (OWC)
Pledged collateral
Private mortgage insurance (PMI)
Reverse annuity mortgages
Second mortgages
Self-contracting
Shared equity
Shared housing/housemates
State mortgage bond programs
State VA mortgage programs
Subprime mortgages
Sweat equity
Tenant-in-common (TICs)
USDA Rural Development Loans (formerly FmHA mortgages)
VA assumable w/qualifying
VA mortgages
VA REOs with VA financing for non-veterans
Wraparounds

For the Answers You Need, Go Beyond Automated Underwriting

Some unthinking loan reps just plug your financial information into their computer AU system (automated underwriting) and provide an easy answer. Loan reps who follow a quick and simple approach not only fail to explore all choices, they slight you in a more seriously deficient way. Their “one size fits all” mindset ignores contextual data that explicitly reviews where you are now, where you would like to go, and the best way to get there. Never accept an AU-generated response, until you answer questions such as the following:

- ◆ What are your goals to build wealth?
- ◆ How do your household expenses differ (positively or negatively) from the affordability assumptions imbedded in the AU computer software?
- ◆ Do you spend, save, and invest to achieve your life priorities?
- ◆ How long do you plan to own the property?
- ◆ How can you improve your credit scores?
- ◆ How can you improve your qualifying ratios?
- ◆ What percent of your wealth should you hold in property?
- ◆ What types of real estate financing (other than those offered by the lender you’re talking with) might best promote your goals for cost savings or wealth building?
- ◆ What types of real estate financing (other than those offered by the lender you’re talking with) might best enhance your affordability?
- ◆ What type of property (fixer, foreclosure, duplex, fourplex, single-family house, condo, apartment building, commercial, and so on) might advance you toward your financial goals?
- ◆ How much would a larger down payment save you?
- ◆ Should you use a fixed-rate or an adjustable rate mortgage (ARM)? Given your situation, what are the risks and opportunities of each? Which choice offers the best trade-off of risk and return (quickest buildup of property equity)?

Although savvy loan reps can help you answer life-planning questions, the majority will not. The majority lack time, knowledge, and incentive to

guide you. Loan reps are like car salesmen. They encourage you to buy product(s) they are selling. Would you expect unbiased auto advice from the sales agent at the Honda dealer? No? Then why would you expect unbiased advice from the loan (sales) rep at the Old Faithful Mortgage Company?

Recall the theme of *Mortgage Secrets*: First, take measure of yourself. Learn your choices. Arrange your property purchase and financing decisions to advance your life goals. A majority of borrowers err because they attempt to minimize their monthly payment rather than maximize their wealth.

Most lenders compare income to monthly payments, but you need more depth, more vision. Decide for yourself: Should you buy more (or less) property than an AU system suggests? Should you borrow more (or less) than this lender's guidelines recommend?

Practice Possibility Thinking

The folks who urge you to get preapproved for a loan rarely mention that you can choose from hundreds of loan products. Each of these products may vary as to interest rate, down payment, credit standards, monthly payments, mortgage insurance premiums, qualifying ratios, closing costs, eligible properties, occupancy standards, and many other terms and conditions. In fact, banks and mortgage brokers may not offer many of the best purchase and financing possibilities.

Sometimes you can even design and create a financing plan. Though most borrowers choose some off-the-shelf loan product, some lenders (and many sellers) will customize specifically—if you know how to ask, and what to ask for.

As you read through *Mortgage Secrets* and reflect upon the ins and outs of property finance, ask yourself, “Would this idea work for me (us)?” Today, financing options exist for nearly everyone who wants to own a home, refinance a home, or buy an investment property. Know the possibilities. Cut wasteful personal spending. Shape up your credit profile. Lift your credit scores. Look for ways to reduce the costs of your loan. Explore the many paths that lead to alternative financing.

As you will see, possibility thinking pays big returns.

SECRET # **2**

How you choose your property and arrange financing can add (or subtract) tens (or even hundreds) of thousands of dollars to (from) your net worth.

Do you think you want to own a single-family house, a condo, or coop? Before you decide for sure, answer this question: Would you instead be willing to live in a fourplex for three to five years if that choice plumped up your wealth by \$100,000 or more?

Own a Rental Property; Boost Your Affordability and Wealth-Building

For purposes of loan “preapproval,” most loan reps assume that you’re buying a single-family house or condo. The loan rep might say that, based on your income and monthly payments, the bank would loan you \$200,000. If you’ve got \$50,000 for a down payment, you could look at houses (or condos) in the \$250,000 price range.¹

Now see how much more you could afford to borrow if you bought a fourplex, lived in one unit, and rented out the other three. Since your rental income from three units will expand your borrowing power, you could buy a property worth say \$600,000 (instead of \$250,000).²

If each of these potential properties appreciates at 4 percent per year, and if after five years the mortgage balance on each falls to 92.5 percent of the original balance, you can see in Table 1.1 how your equity would build with each property.

The part home, part rental fourplex expands your affordability and boosts your net worth by \$173,250 (vs. \$70,000 for the house). The fourplex more than triples your original cash investment. Although specific property

¹ Don’t concern yourself with the specific dollar amounts used in this or other examples. Focus on the idea or technique. Naturally, your finances and the property prices in your area may run higher or lower than the numbers used as examples throughout *Mortgage Secrets*.

² *Mortgage Secrets* discusses the exact numbers in Chapter 2.

Table 1.1 **5-Year Equity Buildup**

	<i>Single-Family House</i>	<i>Fourplex</i>
Purchase price	\$250,000	\$600,000
Amount financed	200,000	550,000
Appreciated value @ 4 percent p.a.	305,000	732,000
Mortgage balance year five	185,000	508,750
Equity	120,000	223,250
Original down payment	50,000	50,000
Investment gain	70,000	173,250

results vary, this example shows the powerful wealth-building effects of leverage (OPM). With the fourplex, you employed other people's money to create your productive money.

Other Wealth-Building Ideas

Later chapters further show how your property purchase and financing decisions will impact your net worth 5 to 20 years in the future. You will learn to evaluate mortgage prepayments, short-term mortgages, fix-up properties, bargain-priced properties, foreclosures, real estate owned (REOs), and low-interest-rate financing.

Few homebuyers or investors compare thoroughly. Most people figure that their property will appreciate. Eventually they'll make a fair amount of money. No doubt, history proves them correct; however, history also shows that buyers who weigh and consider a range of property and loan choices can build much larger investment gains.

SECRET # **3**

Separate the emotional from the financial.

Avoid emotional impulses. Identify, clarify, and separate emotions from your financial goals and motives.

Personal versus Financial

Did you quickly dismiss the idea of buying a fourplex? Was it a gut emotional decision, such as “I don’t want to call an apartment building home—even if I am the owner”? Or, did you look at the money that you could make and decide that even with an extra profit of \$100,000, it’s not worth it?

Subtle Distinction

Emotional decision makers quickly decide an issue according to their whims of superficial likes and dislikes. They pass by future fortunes for present comfort. For example, do you know people who drive new or nearly new cars with big loans but can’t afford to save or invest in property? How many people turn down bargain-priced fixers because they don’t want to make the repairs? How many renters remain long-term renters because buying would give them a longer commute or place them in a neighborhood that seems less desirable than where they currently live?

Just recently, I erred along these lines. (Yes, even pros can make mistakes—especially when they forget to follow their own buying rules.)

Emotional Delay (or Withdrawal)

In this case, the pro was me. I evaluated an investment property (a single-family house). The owner agreed to finance the property with just 5 percent down. The property was located in a neighborhood of professionals; it suffered no problems of disrepair or deferred maintenance. However, notwithstanding these advantages, a couple of features in the house turned me off. I hesitated to make an offer. Rather than quickly weighing all advantages and disadvantages, I focused only on what I didn’t like.

That was a big mistake. The next investor who looked at the property bought it. My failure to quickly size up the opportunity cost me an excellent property that was offered with terrific seller financing.

Avoid Mistakes Similar to Mine

Separate the financial from the emotional—only then will you judge fairly whether the decision exposes you to more cost than benefit. As humans, we seem to be hardwired with emotional response. Yet, to build your financial future you can’t let emotions control. Persistently weigh and consider. Yes,

identify what you like and don't like, what you want and don't want. Then attach a dollar price tag. Don't think here and now. Think of your future returns.

Throughout *Mortgage Secrets* you'll discover dozens of property purchase and financing techniques. Each of these offers trade-offs. Some require effort, inconvenience, or discomfort that at first glance may seem unappealing. Please, though, leave that possibility in view until you've examined it closely. Do now what most people won't do. In 10 years, you'll do what most people never can.

SECRET # **4**

Align self-talk with your priorities.

Are you reading *Mortgage Secrets* to learn how to deal with shaky credit, low cash, affordability, and so on? Good! You'll find more creative financing ideas here than anywhere else. Yet to focus on creative financing begs the ultimate question: Why do you confront such financial issues? Are you managing your money as well as you could?

Self-Defeating Self-Talk Destroys Wealth-Building

Dr. Shad Helmstetter explains that we create our own difficulties (financial and otherwise) through self-defeating self-talk (*What to Say When You Talk to Yourself*, Pocket Books, 1987). Do any of the following statements creep into your self-talk?

- ◆ I can't remember names.
- ◆ I'm always running late.
- ◆ I can never get organized.
- ◆ I'm always short of money. I just don't know where it goes.
- ◆ No way could we ever save enough for a 20 percent down payment.
- ◆ No way could we ever afford a property in that neighborhood.
- ◆ Get qualified for a mortgage? Not with my credit.
- ◆ At the rate we're putting away money for retirement, I'll probably be working until I'm 75.

- ◆ I don't believe that infomercial hype. I know that I could never raise enough cash to invest in real estate.
- ◆ I just can't seem to lose weight.

According to Dr. Helmstetter, none of these self-descriptors actually states a fact. But they do determine your future. "The more you think about anything in a certain way," Helmstetter writes, "the more you believe that's the way it really is." And when you believe "that's the way it really is," you do nothing to solve the problem.

The complaint denies your ability to change your behavior. Self-denial vanquishes potential improvement. Now, here's how to bring about the results you really want.

Reprogram Your Thoughts to Deliver Self-Fulfilling Messages

Reprogram your self-talk. Erase your self-denying complaints. Never describe your behavior in self-demeaning ways. Give yourself a jolt each time you let self-denying assertions short-circuit your search to improve.

As you eliminate self-defeating self-talk, replace it with goal-promoting self-talk. Ask yourself questions. Brainstorm answers. Adopt attitudes and habits that advance you toward the life you would like to live.

For example,

- ◆ What are six ways that I can save more?
- ◆ What are six ways I can cut spending?
- ◆ What are four ways I can stop running up credit card bills and start paying them down?
- ◆ What are four ways that I can work toward a \$1 million net worth within 15 years?
- ◆ How can I use real estate to help build wealth?

Ask questions that point to where you want to go. Invite solutions into your thoughts. With solutions in view, you motivate yourself to advance toward your goals. Determine how you must change. Create promises to yourself. Live those promises.

Does Self-Talk Work?

Absolutely! I rely on positive self-talk to help avoid all health problems; to maintain a vigorous program of diet, fitness, and exercise; to improve work productivity; and, yes, to save, invest, and spend wisely. Self-affirming, goal-directed self-talk gives you a promising outlook on life. Don't just take my word for it. Go to Amazon.com and search for Shad Helmstetter. His book has accumulated more than 50 reviews with a near perfect five-star rating.

Get Started Now

Review your spending, borrowing, saving, and investing. Where does your money go? Will your current money practices transport you to the life you want to live 5, 10, 20 years from now? Or look at it like this: At current rates of interest, each \$100 per month you cut from your spending and instead devote to financing a property can add \$15,000 to your borrowing power, and up to \$50,000 (or more) to your future net worth.

Look at Table 1.2 and fill in the monthly amounts in each category. Do your spending, borrowing, and saving demonstrate a happy outlook for mortgage qualifying, property investing, and lifetime accumulation of \$1 million (current dollars) or more?

If you doubt that money habits can power your wealth building, read *The Millionaire Next Door*, by Thomas J. Stanley and William D. Danko (Longstreet Press, 1996). You'll see that most people who become millionaires do so through saving and investing—not because they earn six-figure salaries.

Suggested Improvements

Do your spending habits show fits of extravagance, excessive borrowing, too little saving, and a general mismatch with your priorities? Yes? Then match your behavior to your self-made promises. Use these techniques:

- ♦ *Think priorities.* Think reward. Realign your money habits to promote your highest values. What do you want most for the next 10, 20, or 40 years?

Table 1.2 **Your Spending Profile**

Rent	\$ _____
Electricity	\$ _____
Gas	\$ _____
Cable TV	\$ _____
Internet charges	\$ _____
Online charges	\$ _____
Telephone(s)	\$ _____
Car payment no. 1	\$ _____
Car payment no. 2	\$ _____
Gasoline	\$ _____
Automobile insurance	\$ _____
Groceries	\$ _____
Child care	\$ _____
Clothing	\$ _____
Electronics	\$ _____
Lunches	\$ _____
Dining out	\$ _____
Entertainment	\$ _____
Tobacco	\$ _____
Beer, wine, liquor	\$ _____
Other vices	\$ _____
Health club	\$ _____
Magazines	\$ _____
Newspapers	\$ _____
Furniture	\$ _____
Appliances	\$ _____
School expenses	\$ _____
Health insurance	\$ _____
Weekend trips	\$ _____
Vacations	\$ _____
Housekeepers	\$ _____
Personal care	\$ _____
Credit card interest	\$ _____
Other	\$ _____
Total	\$ _____

- ♦ *Stop paying rent.* For most people who don't yet own their own homes, rent wastes money. Can you eliminate or reduce rent payments? Can you switch to a lower cost apartment? Can you house share? Can you find a house-sitting job for the next 3 to 12 months? Can you move back with your parents or stay rent free with relatives or friends? Bank your rent money for 6 to 12 months, and for the rest of your life you'll never pay rent again.
- ♦ *Cut your food bills in half.* Eliminate restaurant meals. Bring brown bag lunches. Buy unbranded foods in bulk. Prepare your food in large quantities and freeze portions in meal-sized servings. Locate a remainder and closeout grocery like Canned Foods, Big Lots, or Drug Emporium. Food prices in discount stores run 20 to 50 percent less than in big name supermarkets. When you find bargain-priced items that you use regularly, buy them by the case.
- ♦ *Cut your credit cards in half.* Stamp out credit card addiction. Throw away your needles. Adopt a strict cash diet. You will spend far less when you count out real cash. Besides, credit card balances zap strength from your constructive borrowing power. By the time you pay off your credit card balances at 18 percent interest, you pay back two (or more) dollars for every dollar you originally charged—and that's in after-tax, take-home dollars. Since you only take home 65 to 80 percent of what you earn, you have to earn more than \$2,000 just to pay back every \$1,000 you charge on your credit cards.
- ♦ *Don't put the car before the house.* If you own a car that's worth nearly as much as a down payment on a house, sell it. Get rid of those cash-draining car payments. If the car(s) is (are) mostly paid for, a sale provides a good part of the cash you need to finance a property. If you are thinking about buying a more expensive car, stop! Until you can afford your perfect home, until you have built up the wealth you want, drive the least expensive, dependable car you can find. Use debt only to acquire appreciating assets. If property prices in your area do not offer a great risk/reward ratio, invest in other parts of the country—or the world.
- ♦ *Eliminate costly vices.* How much do you spend on cigarettes, beer, liquor, drinks at restaurants, clubs, or bars, illegal drugs, or other