Participant Guide

A ROOF OVER YOUR HEAD

FDIC Money Smart for Young Adults

Building: Knowledge, Security, Confidence

Table of Contents

Money Smart for Young Adults Modules

Bank On It
An introduction to bank services

Check It Out
How to choose and keep a checking account

Setting Financial Goals
How to keep track of your money

A Roof Over Your Head
Why you should save, save, save

Borrowing Basics
An introduction to credit

Charge It Right
How to make a credit card work for you

Paying for College and Cars
Know what you are borrowing before you buy

A Roof Over Your Head
What home ownership and renting are all about

Your Guides

Students from Lakeview High are going to be your guides in this lesson.

Jasmine

Hobbies: Hanging out with friends, shopping, collecting teddy bears
School life: Likes English class, swims on the swim team
Job: Works weekends and holidays at her aunt’s gift shop
Family: Younger brother named Dominique, large extended family
Future plans: Go to an in-state college and become an exercise physiologist

Todd

Personality: Shy, good sense of humor, intelligent
School life: Likes school, but does not work very hard at it
Jobs: Two part-time jobs (fast food and a grocery store)
Family: Mom and sister
Future plans: Attend college; he is not sure where he wants to go or how he will pay for it, but is saving all he can

Ramón

Hobbies: Going to the movies or playing mini golf with his girlfriend
School life: Plays on the soccer team
Family: Born in the United States (U.S.), but his parents are from Peru; he has a little sister and an older brother who is a pilot in the Air Force
Job: Repairing computers; wants to work for NASA some day
Future plans: Attend college on a soccer scholarship to study engineering

Grace

Hobbies: Art, drawing fashion sketches
School life: Does not really fit into the "high school scene"
Family: Two parents, no siblings
Job: Works at a clothing store at the mall
Future plans: Enroll in Fashion Design School

Checking In

Welcome

Getting your first apartment or home is fun and exciting, but it can be expensive to move in and the costs of securing a space of your own could be more than you are ready for. In this module you will learn how to decide if you are ready.

Purpose

A Roof Over Your Head will give you the information you need to make informed choices about renting your first apartment, determining your readiness to buy a home, and buying a home of your own.

Objectives

After completing this module, you will be able to:

- Identify initial and continuing costs of renting an apartment.
- List questions to ask when determining if you are ready to buy a home.
- List the costs associated with renting and owning.
- Describe the benefits and pitfalls of renting versus owning a home.
- Identify how you can guard against predatory lending practices.

Student Materials

You have a copy of the *A Roof Over Your Head* Participant Guide. You can take it home and use it as a reference. It contains:

- Information and activities to help you learn the material
- Tools and instructions to complete the activities
- Checklists and tip sheets
- A glossary of the terms used in this module

Pre-Assessment

1. One large cost of getting an apartment is the:
    a. Security deposit
    b. Interest payment
    c. Escrow
    d. Mortgage

2. The best choice below for keeping rent affordable is to:
    a. Ask for a rent extension
    b. Get a roommate
    c. Choose not to have utilities connected
    d. Have a pet

3. When you apply for a lease, the landlord will usually require:
    a. A request for new carpeting
    b. An interest payment
    c. A security deposit and rent paid up front
    d. Private Mortgage Insurance (PMI)

4. Jake is thinking of buying a house. What is the most important question he should ask himself?
    a. Can I get a dog?
    b. Will the water heater work?
    c. What kind of lawnmower should I buy?
    d. Am I financially ready?

5. Maddie graduated from high school this year and has her first job. She feels ready to move into her own space and has $1,200.00 in savings. Which is the best choice for her?
    a. Renting, because she does not have enough saved to buy a house
    b. Buying a house, because she can build equity for more money
    c. Renting, because she heard she can save on taxes
    d. Buying, because she can play her stereo as loud as she wants

6. A mortgage is:
    a. A loan to buy a home
    b. Money used as a down payment
    c. Money set aside to pay taxes
    d. A fee to pay when you rent an apartment

7. What are the advantages of owning a home? Select all that apply.
    a. You are not responsible for property maintenance and upkeep
    b. You can reduce your income taxes by deducting mortgage interest and property taxes
    c. You will have costs (e.g., property taxes, maintenance expenses, homeowner's insurance)
    d. You may be able to build equity

8. When renting an apartment or home:
    a. Your payment for rent may increase
    b. Homeowner's insurance will be required
    c. You are responsible for property taxes
    d. You are the owner of the property

9. An escrow account is for:
    a. Money used as a down payment
    b. Money set aside to pay property taxes and homeowners insurance
    c. A loan to buy a home
    d. A fee to pay when you rent an apartment

10. Charles is thinking of buying a house. Which questions should he ask himself before buying? Select all that apply.
    a. Where do I want to live?
    b. What type of home do I want?
    c. How do I want to furnish the home?
    d. Am I financially ready and able to buy a house?

11. What are the benefits of renting?
    a. You can build equity
    b. Your rent might increase
    c. Property maintenance is the responsibility of the landlord
    d. You receive a federal tax deduction for your mortgage interest

12. Which of the following are signs of predatory lending practices and loan scams? Select all that apply.
    a. Demand for upfront fees
    b. Verbal promise documented in writing
    c. Contracts/documents with blank lines or spaces
    d. An unsolicited offer that you are told is only valid for a few hours so you need to “act now”

13. What should you do before you rent or buy a home?
    a. Read the paperwork (e.g., lease or mortgage documents)
    b. Shop around and compare costs
    c. Make sure you can afford the monthly payments
    d. All of the above

14. Which of the following statements about renters/homeowners insurance is false?
    a. It is always required if you rent
    b. It protects against the loss or destruction of your possessions and property
    c. It protects you if someone is injured in your home or on your property
    d. It covers your expenses if you cannot live in your home because of damage

15. A mortgage payment includes which of the following? Select all that apply.
    a. Principal
    b. Interest
    c. Closing costs
    d. Security deposit

Thinking About Moving Out

Consider the following scenario:
You have just finished school, and you have your first full-time job. You make $1,600.00 per month (about $10.00/hour). Your monthly net income (or take-home pay with deductions taken out) is about $1,200.00. You have about $600.00 in savings from your previous part-time job.

Do you think you have enough money to move out of your parents' house and get your own apartment, or even buy your own home?

Renting versus Buying

Advantages of Renting
Advantages of renting include the following:

- Property maintenance is the responsibility of the landlord.
- You are generally only under a rental contract for 1 year or less. That means that after the term of the lease expires, you can notify the landlord that you are moving.
- You do not have other costs associated with owning a home (e.g., property taxes or homeowners insurance).

Renters insurance can be obtained from the same companies that sell homeowners insurance, and it is generally cheaper than homeowners insurance.

Disadvantages of Renting
When you rent:

- You are not the owner of your home.

- Your rent might increase.
- You might not be able to renew your rental contract and then you will have to find a new place to live.
- You will not receive a federal tax deduction for your rent payments; however, mortgage interest is tax deductible.

As a homeowner, you can enjoy several benefits:

- You can build equity. *Equity* refers to the value of the home minus the debt you owe on it. You can build equity in two ways. First, you build equity as you pay down the loan (assuming the value of your home does not drop). Second, homes may *appreciate*, or increase in value over time.
- Equity is wealth. You can borrow against it for many purposes (e.g., education, home renovations, and other long-term investments), usually at a relatively low interest rate. Be very careful and think twice before borrowing against your hard-earned home equity because you could lose your home if you do not, or cannot, pay back the loan.
- Once your mortgage is paid in full, the home is yours.
- Home ownership may reduce the amount of income tax you owe since mortgage interest and property taxes are deductible.

When you own a home, property maintenance and upkeep are your responsibility. You are also responsible for the additional costs of:

- Homeowner's insurance
- Other types of insurance if required by the lender (e.g., flood or earthquake insurance)
- Real estate taxes
- Homeowner's association fees, if applicable, to pay for maintenance of the common areas and the exterior of the buildings and grounds.

When you own a home, it is not as easy to move as it is when you rent. You may have to sell or rent your home before you can afford to buy or rent another one.

Renting Your Own Space

Lease

Before you rent an apartment or house, you will be asked to sign a lease. A *lease* is a legal document that protects you and the landlord by clearly stating the arrangement between the two of you.

The lease states that:

- The landlord agrees to provide you with a space that it is in "livable" condition (e.g., free of bugs and mechanical defects)
- You agree to pay a certain amount, by a certain date, and for a set time period (e.g., 1 year)
- Fees may be charged for specific items (e.g., if you make a late payment or have pets)
- Each party's responsibilities (e.g., the landlord must maintain the property and you must keep your rental property in good condition)

You have certain rights as a renter. Visit the U.S. Department of Housing and Urban Development (HUD) website at *http://www.hud.gov/renting/* to learn more.

Costs to Move In

The costs of securing a rental property usually include:

- A security deposit
- Payment of the first month's rent
- Fees, including credit report fees or pet fees
- Costs of connecting utilities (electric, phone, and water)

Security Deposit

A security deposit is money you put on deposit with the landlord when you sign the lease. It is held in an account by the landlord during the term of your lease. The deposit is considered a guarantee that you will stay for the length of your lease term and not move out early or without notice. The security deposit is also used when you move out to help pay for any damages to the property other than normal wear and tear. If there are no damages, the money is returned to you. The amount of a security deposit can vary, but it is usually equal to at least 1 month's rent. It may be based in part on your credit history.

Upfront Payments

You must generally pay your first month's rent (or an amount that is prorated or based on the remaining days left in the month if you move in before the first of the month) along with your security deposit when you sign a lease.

Additional Fees

Non-refundable move-in fees are common in some areas. These cover the cost of preparing the rental property for your move in. Some landlords may also charge non-refundable application or credit report fees (which may be negotiable and restricted by law in some cities or states) to assess your eligibility to rent the rental property.

Utility Connection Fees

Utility companies (i.e., water, gas, electric, telephone, and cable) usually charge a connection fee to begin service. You may pay the connection fees before your service is connected or when you receive your first bill. The fees may vary from $35.00 to over $100.00, depending on the services you are receiving.

Utility companies may also request a security deposit. Whether they request a deposit, and the amount they request, is generally based on your credit and utility payment history.

Monthly Expenses

Your monthly renting costs may include:

- Rent
- Fees (storage, pet fees, parking, etc.)
- Utilities
- Renters insurance, which is usually optional

Rent and Fees

A good rule of thumb is that you should spend no more than 30 percent of your gross income (amount before deductions are taken out) on rent.

That means if your gross income is $1,600.00, you should spend no more than $480.00 on rent. Then you will have the remainder of your income for other expenses (e.g., additional fees, utilities, insurance, and personal expenses).

Some properties have fees in addition to the rent. For example, do you plan to have a cat or dog? Many landlords charge monthly fees and a deposit for pets. You might also pay extra to rent a storage space or a parking space in some neighborhoods.

Utilities

You will have to pay monthly utility charges, unless utilities are included in your rent. Be aware that utility bills may vary according to your use and the seasons or climate (e.g., hot or cold weather) and can become quite expensive. Many utility companies offer a budget plan so that you pay the same amount throughout the year.

Renters Insurance

Renters insurance is usually optional, although some landlords may require you to obtain coverage when you move in. Renters insurance:

- Protects you against the loss or destruction of your possessions in the event your property is stolen or damaged (e.g., through a fire or burglary)
- Covers your living expenses if you are unable to live in your rental property because of a fire or other covered circumstance
- Provides liability protection in the event that you are held responsible for another person’s injury or property (e.g., if a guest trips, falls, and is injured while visiting your home)

Earthquake or flood insurance may be available at an additional cost.

Rent Increases

Your landlord is not allowed to raise the rent during the term of your lease. For example, if you sign a 1-year lease your rent payment will stay the same for that year. However, at the end of your lease the landlord may raise your rent. Some communities have rent-control laws that govern rent increases, others do not. Be prepared. When shopping for a rental property, it is a good idea to pay *less* in rent than the maximum that your budget would permit you to pay. That way, if you stay after your lease expires, you will have some financial room in your budget to cover rent increases.

Sharing Space: Roommates

Many young people share an apartment or house with one or more roommates to save on the costs of renting. If you are renting with others, and your name is on the lease and utility accounts, consider your roommate's ability to pay his or her portion of the expenses and his or her history of paying bills on time. If he or she is late paying bills or unable to pay the bills, you could be impacted financially (e.g., requiring you to pay more than you expected or it could affect your credit history).

Activity 1: Can You Afford to Rent?

Review the rental costs at Pine Tree Apartments. Compare these costs with your estimated income and rental and living expenses. Then answer the questions.

Scenario

You have $500.00 in savings and $125.00 in cash. You start a full-time job and your take-home pay is $1,400.00 a month.

You are currently living with your parents and only have to pay a monthly car payment of $195.00 and a cell phone bill of $56.00. You also spend about $100.00 on gas and have been saving $50.00 a month. That leaves you with about $800.00 each month for entertainment, food/eating out, personal expenses, and additional savings toward an apartment.

You are anxious to move out on your own. You begin to look at 1 or 2 bedroom apartments at the Pine Woods Apartments to determine whether you can afford it yet.

Pine Woods Apartments: Rental Expenses	**1-Bedroom**	**2-Bedroom**
Security Deposit	**$ 500.00**	**$ 650.00**
Application Fee	**$ 10.00**	**$ 10.00**
First Month's Rent	**$ 400.00**	**$ 550.00**
Total to Move In	**$ 910.00**	**$1,210.00**

Income	
Savings	**$ 500.00**
Available Cash	**$ 125.00**
Total Initial Funds	**$ 625.00**
Total Monthly Funds	**$1,400.00**

Estimated Living Expenses if Renting	
Utilities (e.g., water, electric/gas, cable, Internet, and phone)	**$200.00**
Food	**$200.00**
Car payment	**$195.00**
Car insurance	**$ 75.00**
Gas	**$100.00**
Cell phone	**$ 56.00**
Savings	**$ 50.00**
Estimated Total	**$876.00**

1. Based on your total initial funds, can you afford to move into a 1-bedroom apartment at the Pine Woods Apartments today?

   ____
2. How much more money would you need to save to move into a 1-bedroom apartment? ______________________________
3. How long will it take you to save that amount if you continue to save $50.00 a month? ______________________________
4. Could you afford the monthly rent (for a 1-bedroom apartment) and your estimated expenses based on your income? _________
5. You and your best friend decide to rent a 2-bedroom apartment together. If you split the costs to move in (security deposit, application fee, and first month's rent), what would it cost each

of you to move in, and could you afford it?

____

6. Could you afford the monthly rent and your expenses if you shared a 2-bedroom apartment? ________________________

Buying a Home

Homes can be expensive. Therefore, they are often not affordable for a young person who has yet to accumulate savings, demonstrate a steady source of income, and build a credit history.

A *mortgage* is a loan, provided by a financial institution to buy a house or condo. Most first-time homebuyers obtain a mortgage to help finance the home.

You repay the mortgage over long periods of time, usually 15 to 30 years. Before we talk about several different types of loans, let us talk about mortgage costs and how to determine if you are financially ready to buy a house.

Mortgage Costs

The costs involved in buying a home include:

- **Closing costs:** Closing costs are fees associated with buying and settling, or finalizing, your loan. They can include property taxes, broker and attorney fees, inspection fees, title insurance, and many other items.
- **Taxes and Insurance:** You will probably have to pay some taxes up front. The locality (usually county and state) where you live will charge taxes on the property. Taxes are generally paid up front at the time of closing on a mortgage and either once or twice a year thereafter. They can amount to several thousand dollars per year, depending on the value of your house and the state where you live.
  You also need homeowner's insurance to protect you financially. Homeowner's insurance will cover you in the event of an accident (e.g., if your house catches on fire, the basement floods in a storm, someone falls or is injured on your property,

or if a window breaks due to a flying rock/debris from a lawn mower). You would have to obtain other insurance (e.g., flood or earthquake insurance) separately.
- **Interest:** Interest is the cost of borrowing money. You pay the mortgage company interest every month as a portion of your monthly mortgage payment.

Down Payment
The down payment is an initial payment you make when buying a home to help lower your mortgage costs and monthly mortgage payments. You will generally pay a percentage of the cost of the home you want to buy. Typically, down payments are between 3 and 20 percent of the purchase price. That means that if you want to purchase a townhouse for $100,000.00, you will have to pay at least $3,000.00 up front.

Am I Ready to Buy a Home? Checklist
You must be financially ready to buy a home. You should also be ready personally and professionally. For example, you would not want to buy a home while you are in college, even if you had the money, because your career may take you somewhere else (e.g., another part of the state or another state).

Ask yourself these questions as you consider whether to buy a home:

- Do I have a steady source of income? This usually means you have a job or other reliable sources of income.
- Have I been employed or received this income on a regular basis for at least 2 or 3 years?
- Do I have a good credit history (good record of repaying debts)?
- Do I have the ability to make the mortgage payment every month and pay additional costs for taxes, insurance, maintenance, and repairs? In addition to this, can I still afford to pay my other bills and debts?
- Do I have money saved for a down payment and closing costs?

- Do I have money saved for emergencies (e.g., if unable to work; for medical expenses; and for home, car, or appliance repairs)?

These are some questions you need to ask yourself to determine if you are ready to buy a house. If you can answer "yes" to these questions, you might be ready to buy. If you answered "no" to any of the questions, concentrate on strengthening those areas.

Four Cs

Lenders may also ask you some of these questions when you apply for a loan. Lenders use the Four Cs of Loan Decision Making to qualify you for a loan:

- *Capacity* is your present and future ability to meet your payment obligations. This includes whether you have enough income to pay your bills and other debts.
- *Capital* refers to the value of your assets and your net worth.
- *Character* refers to how you have paid bills or debts in the past. Your credit report is one tool lenders use to consider your willingness to repay your debts.
- *Collateral* refers to property or assets offered to secure the loan.

Help for Purchasing

There are a number of different homebuyer assistance programs available, particularly for first-time homebuyers. The programs generally lower the costs of buying a home by providing down payment assistance or reduced interest rates.

Many cities and local governments offer homebuyer assistance programs, especially for people with lower incomes. There are also special government homebuyer assistance programs for teachers and service personnel.

Activity 2: Is Ramón Ready to Buy?

Read the scenario and answer the questions. Be prepared to discuss your answers.

Scenario

Ramón has graduated from college. He has begun his career as an engineer. Now he thinks he may be ready to buy a condo or townhouse.

Ramón's gross pay is $4,100.00 a month and his net, or take-home, pay is $3,075.00. He has been saving for a down payment and closing costs and has $4,200.00 saved so far. Ramón contacted his state's Housing Finance Authority and learned about a program that helps first-time homebuyers with their down payment and closing costs. The program matches the amount the buyer has saved to buy a home. That means he would have $8,400.00 he could put toward a down payment and closing costs. He enrolls in the program and completes several homeownership classes that are part of the program's requirements.

In the middle of his home ownership training, a banker works with Ramón and pre-qualifies him for a maximum mortgage amount of $165,000.00. *Pre-qualification* is an informal way to find out how much money you can borrow. Ramón is also eligible to pay only a 3 percent down payment because he is a first-time homebuyer.

As a rule of thumb, many people estimate they are able to afford a mortgage of 2 to 3 times their household income. Ramón's annual income is $49,200.00, so he might be able to afford a mortgage of $98,400.00 to $147,600.00.

$49,200.00 x 2 = $98,400.00
$49,200.00 x 2.5 = $123,000.00
$49,200.00 x 3 = $147,600.00

Keep in mind that if you qualify for a higher amount, that does not mean you can afford or will be comfortable with those monthly payments. Consider your own circumstances and your future financial needs and goals.

Ramón has found a townhouse that he likes. It is listed for $140,000.00. The lender estimates that Ramón would need $4,200.00 for a 3 percent down payment and $7,000.00 (5 percent of house cost) for closing costs.

Ramón's Funds		**Purchase Cost**	
Down payment and closing costs	**$4,200.00**	Cost of House	**$140,000.00**
Matched Savings	**$4,200.00**	Down payment	**$4,200.00**
		Closing Costs	**$7,000.00**
Total funds available $8,400.00		**Total funds to purchase $11,200.00**	

1. Does Ramón have enough money for the down payment and closing costs? ________________________
2. If no, how much more does he need? ____________________
3. Do you think Ramón is ready to buy a home? If not, what does he need to do be better prepared?

   ____

   ____

   ____

The Mortgage Payment

What makes up a mortgage payment?
A mortgage payment is more than just paying back the amount you owe on a home loan. Your mortgage payment will reflect the following costs:

- **Principal:** the amount applied to the outstanding balance of the loan
- **Interest:** the amount of the charge for borrowing money
- **Taxes:** an amount equal to 1/12th of the estimated annual real estate taxes on the home
- **Insurance:** an amount equal to 1/12th of the annual

homeowner's insurance premium

- In addition to homeowner's insurance, this figure may include flood or earthquake insurance.
- For more information on flood insurance and preparing for disasters, visit www.fema.gov and www.ready.gov.

- **Private Mortgage Insurance (PMI)**: if required

Escrow

Taxes and homeowner's insurance are often paid from an *escrow account*, which is a special bank account held by a financial institution for the purpose of paying taxes and insurance. When the financial institution calculates your mortgage payment, they include 1/12 of your estimated annual property tax bill and insurance premium. When you pay your mortgage, the lender deposits this portion of your payment into the escrow account so the financial institution can pay the tax and insurance bills on your behalf when they come due.

In some cases, PMI is required to protect the lender if the buyer does not pay the loan. Although this is paid with the mortgage, it is also deposited into the escrow account and paid to the mortgage insurance company.

You can pay taxes and insurance separately, but you will be responsible for saving money for and paying the tax and insurance bills each year. The bills may total several thousand dollars, so you would only want to pay them separately if you are disciplined enough to save.

Activity 3: Can Ramón Afford a Mortgage?

Based on the townhouse he wants to buy for $140,000.00, Ramón's mortgage payment will be approximately $993.00 per month. Let us see if he can afford that amount.

Lenders usually require the principal, interest, taxes, and insurance (PITI), or your total housing expenses, to be less than or equal to 25 to 28 percent of your monthly gross income.

Ramón's monthly gross income is $4,100.00. What is the maximum monthly mortgage payment recommended for Ramón?

Mortgage Shopping

Mortgage Options

Other factors that affect how much mortgage you can afford include the length or term of the mortgage and whether the mortgage has a fixed or variable interest rate. Most mortgages are typically for 15- and 30-year terms. Fifteen-year mortgages allow you to build equity faster and pay less in interest because you make larger monthly payments and borrow less money. If a 30-year mortgage is more affordable, you can receive similar benefits by paying more than your mortgage payment and applying that extra amount toward the loan principal.

You will also have to choose between a fixed-rate and adjustable-rate mortgage. The interest rate on a fixed-rate mortgage stays the same for the term of the loan. Therefore, your monthly payments are predictable. A fixed-rate mortgage may be a better option for you if you plan to remain in the home for a long period of time.

The interest rate on an adjustable-rate mortgage (ARM) can increase or decrease during the term of the loan. You might have a low rate for an initial period (e.g., 1, 3, 5, 7, or 10 years), and then your payments could increase significantly. These loans may be worthwhile if you:

- Anticipate moving in the near future and are not concerned about potential increases in interest rates that may result in your mortgage payment increasing significantly
- Are reasonably certain your income will increase significantly in the near future.

You may have also heard about interest-only mortgages. With these mortgages, you pay only the interest (not the principal) for a fixed term (generally 5 to 7 years). Then you can:

- Refinance

- Pay the balance in a lump sum
- Start monthly mortgage payments toward the principal

Be very careful with these mortgages because you generally are not paying down the principal, and the interest rate is typically adjustable, meaning the mortgage payments will likely increase over time.

In summary, most homebuyers will find that a 30-year fixed rate mortgage is the safest and most predictable option for their budget.

Shop, Compare, Negotiate

Once you have decided on the type of mortgage you want, there are several steps you can take to get the best price for your mortgage.

- Check advertisements in local newspapers and on the Internet to get an idea of the best deals. Be aware, however, that rates change frequently. Be sure to read the terms and conditions that may apply to offers.
- Contact several lenders on the same day to compare quotes. Do not be afraid to let lenders compete for your business by letting them know you are shopping for the best deal.
- Negotiate for the best price you can get. Ask the lender for better terms than originally quoted. Lenders might offer different prices to different borrowers even with the same qualifications. Ask the lender to waive or reduce one or more of the fees, or agree to a lower rate or fewer *points* (an upfront cost based on a percentage of the loan amount), and make sure the lender does not lower one fee and raise another in its place.
- Make sure the lender gives you all the costs of the loan in writing.
- Use the Annual Percentage Rate (APR) and Loan Estimate to compare all costs.
    - The APR includes the interest rate, points, broker fees, and certain other credit charges that the borrower is required to pay.
    - The Loan Estimate is an itemized list of the costs and fees associated with your loan, given to you in good faith

by your lender or broker. Federal law requires the lender or broker to mail or give you a Loan Estimate within three business days of getting your application.

Fair Housing Act

The Fair Housing Act protects you from discrimination throughout the loan process, from the time you submit a loan application until you receive the final loan approval. It prohibits discrimination on the basis of race, color, religion, sex, national origin, family status (including children under the age of 18 living with parents of legal custodians, pregnant women, and people securing custody of children under the age of 18), or handicap status in housing-related transactions.

Settlement

Settlement, also called closing, occurs when the borrower meets with the seller and other representatives to sign the documents that will finalize the sale of the house and any mortgage financing.

An important document that you have a right to receive at least three business days before the settlement meeting takes place is the *Closing Disclosure*. Compare it to the Loan Estimate to see whether there are changes. There is a chart on the third page of the Closing Disclosure, called "Calculating Cash to Close," that will highlight changes from the Estimate to the final terms. If you do not understand the changes, ask the lender.

Predatory Lending Practices

Predatory lending occurs when companies offer loan products using sales tactics, propose loan terms that deceive borrowers, and use collection practices that frighten people. Predatory lending has become a serious problem and can occur in any sort of lending practice.

Abusive practices can occur in the mortgage, home equity, credit card, auto lending, and payday lending markets. Most of the problems are not caused by federally insured financial institutions.

Predatory mortgage loans involve a wide variety of abusive practices, including:

- **Excessive Fees:** Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. On predatory loans, fees totaling more than 5 percent of the loan amount are common.
- **Abusive Prepayment Penalties:** Borrowers with higher interest loans have a strong incentive to refinance as soon as their credit improves. However, many higher-interest mortgages carry a prepayment penalty—a fee for paying off a loan early. Be careful of prepayment penalties, especially those that last more than 3 years and/or cost more than 6 months' interest.
- **Loan Flipping:** A lender flips a loan by refinancing it several times within a short timeframe to generate fee income, without providing any net tangible benefit to the borrower. Flipping can quickly drain borrower equity and increase monthly payments—sometimes on homes that had been previously owned free of debt.
- **Unnecessary Products:** Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.
- **Asset-Based Lending:** Predatory lenders may approve a loan based on the value of a customer's equity in the home, instead of on his or her ability to repay the loan. The lender may later encourage the customer to default so the lender can take ownership of the home.
- **Steering and Targeting:** Predatory lenders may steer borrowers into subprime mortgages even when the borrowers could qualify for a less expensive loan. Vulnerable borrowers may face aggressive sales tactics and sometimes outright fraud.

Activity 4: Predatory Lending Practices

Read each scenario and identify the predatory mortgage lending practices used.

Scenario 1

Alice had $10,000.00 in credit card debt when she got a letter offering to refinance her home. The lender never asked for her income. She soon regretted her decision to accept the offer. The $40,000.00 subprime refinance loan she took out ballooned to $65,000.00 almost immediately because of prepayment penalties and unanticipated fees.

____

Scenario 2

Jim, 68 years old, took out a mortgage loan on his home in the amount of $20,334.00. His loan was refinanced six times in 6 years, bringing the final loan amount to nearly $55,000.00. He paid for credit life insurance all six times, with each premium exceeding $2,300.00.

____

Scenario 3

Laid off after 29 years of working, Katherine was struggling. Although she had a part-time job working in the school cafeteria, she was not earning enough to pay her bills. When she received a call from a man who said he could help her come up with some cash, it seemed like the answer she had been waiting for. The man said he worked for a home improvement company and that he could find her a loan that would both pay for some remodeling on her house and leave enough cash to pay her bills.

____

How to Avoid Predatory Lenders

There are several steps you can take to avoid being a victim of predatory lenders:

- Pay your bills on time to ensure you have a good credit history and review your credit report every year.
- Be an informed consumer. Shop around for the best deal. If a

lender is unwilling to give you the information you need to comparison shop, you should not do business with him or her.

- Ask friends, family, and credit counselors for advice. Take someone along with you when you talk to a lender.
- Take your time before deciding on the best loan or lender. Do not let lenders pressure you into a decision before you are ready.
- Be careful of lenders who tell you they do not care about your credit history or how much you earn. Many of these lenders charge higher interest rates and higher fees.
- Disregard advertisements that make lending sound cheap and easy.
- Read and understand all documents before you sign them. Keep copies of what lenders give you.

Module Summary

Congratulations! You have completed the *A Roof Over Your Head* module. We have covered a lot of information today about how to save for the future. You learned about:

- The advantages and disadvantages of renting and buying a home
- The costs associated with renting or buying a home
- The questions to ask yourself when deciding if you are ready to have an apartment or home of your own
- Basic mortgage terms and options
- Predatory lending practices

You should now be able to make well-informed decisions in the future when determining whether to rent or buy a home.

Knowledge Check

1. What are the two main costs of owning a home? Select all that apply.
    a. Homeowner's insurance
    b. Security deposits
    c. Real estate taxes
    d. Increasing rent

2. You are ready to buy a house when:
    a. You are tired of living in a rental unit or with family
    b. You have determined that you have the financial ability to buy a house
    c. You have started a full-time job
    d. You have your first child

3. Lenders usually require the PITI, or your total housing expenses, be less than or equal to what percentage of your monthly gross income?
    a. 30% to 50%
    b. 25% to 28%
    c. 10% to 25%
    d. 3% to 20%

4. Match each mortgage payment term with the correct definition.
    Principal: __b__
    Interest: __a__

    a. The amount of the charge for borrowing money
    b. The amount applied to the outstanding balance of the loan

5. Which loan would allow you to pay off your mortgage faster and pay less in interest?
    a. 30-year mortgage
    b. 15-year mortgage
    c. Interest-only mortgage
    d. Adjustable-rate mortgage (ARM)

6. A lease lists:
   a. Your and the landlord's responsibilities for maintaining the property
   b. The amount of your monthly rent and the due date
   c. Fees (e.g., additional charges or late fees)
   d. All of the above

7. When might a security deposit be required?
   a. When you sign a rental lease
   b. When you connect your utilities
   c. When your rent increases
   d. a and b

8. Other than rent, what additional fees might you have to pay when renting?
   a. Pet fees
   b. Closing costs
   c. Interest
   d. Down payment

9. Greg has graduated from college and has held a steady job for 2 years. He is ready to move into a place of his own after living with roommates. He has saved about 10 percent of the price of a home in the neighborhood he is interested in. Which is the best choice for him?
   a. Continue renting because he does not have enough saved to buy a house
   b. Buy a house because he can potentially build equity and perhaps save on federal income taxes
   c. Continue renting because he can save on federal income taxes
   d. Buy a house because he will have less expenses and responsibilities than renting

10. What type of program might help Greg buy a house?
    a. Homebuyers assistance program
    b. Homebuyers insurance program
    c. Homebuyers education program

11. Costs of renting an apartment include which of the following?
    a. Security deposit
    b. Interest payment
    c. Rent payment
    d. Mortgage payment

12. When renting, you should spend no more than ____ percent of your gross income:
    a. 20%
    b. 25%
    c. 28%
    d. 30%

13. When determining if you are ready to buy a home, a lender will look at your credit history and how you have paid bills or debts in the past. This refers to your:
    a. Capacity
    b. Capital
    c. Character
    d. Collateral

14. Which law protects you from discrimination throughout the loan process when buying a home?
    a. Fair Housing Act
    b. Truth in Lending Act
    c. Fair Credit Reporting Act
    d. Real Estate Settlement Procedures Act

Glossary

Adjustable-rate Mortgage (ARM): A mortgage in which the interest rate can increase or decrease during the term of the loan.

Annual Percentage Rate (APR): The cost of credit as a yearly rate. The APR includes the interest rate, points, broker fees, and certain other credit charges that the borrower is required to pay.

Closing costs: Fees associated with buying and settling, or finalizing, your loan.

Collateral: Property or assets offered to secure the loan.

Down payment: A set percentage of the cost of the home you want to buy to show the bank and the seller that you are serious about purchasing the house.

Escrow Account: An account used to hold money and pay for property taxes and homeowners insurance as part of your mortgage payment.

Equity: The value of the home minus the amount you owe on it.

Fair Housing Act: An act that prohibits discrimination on the basis of race, color, religion, sex, national origin, family status (including children under the age of 18 living with parents of legal custodians, pregnant women, and people securing custody of children under the age of 18), or handicap status in housing-related transactions.

Fixed-rate Mortgage: A mortgage in which the interest rate stays the same for the term of the loan.

Interest: The charge for, or cost of, borrowing money.

Interest-Only Mortgage: A mortgage in which you pay only the interest (not the principal) on the mortgage in monthly payments for a fixed term.

Loan Estimate: The law requires that lenders/brokers give you an estimate of the costs and fees associated with your loan within 3 business days of receiving your application.

Mortgage: A loan to finance the purchase of real estate, usually with specified payment periods and interest rates.

Mortgage Insurance: An amount to be paid that is equal to 1/12th of the annual homeowner’s insurance premium.

Points: Charges paid by the borrower at settlement or added to the mortgage amount. One point equals 1 percent of the loan amount.

Pre-approval: A commitment from the lender to lend you money.

Pre-qualification: An informal way to find out how much mortgage you can obtain.

Predatory Lending: A practice of using certain marketing tactics, collection practices, and loan terms that deceive and exploit borrowers.

Principal: The amount applied to the outstanding balance of the loan.

Private mortgage insurance (PMI): An amount added to the mortgage payment, in some cases, that guarantees the loan will be paid for by the mortgage insurance company if the homeowner defaults, or fails to pay the mortgage (for the benefit of the lender not borrower).

Refinance: A process by which an existing home loan is paid off and replaced with a new loan.

Security deposit: Money you give to the landlord when you sign the lease. The lease must state what the security deposit will be used for, and whether or not it is given back to the renter when he or she moves out.

Settlement: When the borrower meets with the seller and other representatives to sign the documents that will finalize the sale of the house and any mortgage financing.

Taxes: An amount equal to 1/12th of the estimated annual real estate taxes on the home.

Traditional Mortgage: A 15- or 30-year mortgage with a fixed or variable interest rate.

Utilities: Services of living, including electricity, water, gas, phone, cable TV, and Internet access.

For Further Information

Federal Deposit Insurance Corporation (FDIC)

www.fdic.gov/consumer

1-877-ASK-FDIC (275-3342)

Visit the FDIC's website for additional information and resources on consumer issues. For example, the quarterly *FDIC Consumer News* provides practical hints and guidance on how to become a smarter, safer user of financial services. Also, the FDIC's Consumer Response Center is responsible for investigating all types of consumer complaints about FDIC-supervised institutions and responding to consumer inquiries about consumer laws and regulations and banking practices.

Consumer Financial Protection Bureau

http://www.consumerfinance.gov/owning-a-home/

1-855-411-2372

The Consumer Financial Protection Bureau, or CFPB, has great resources to help home buyers and mortgage shoppers such as worksheets, tools to compare loan offers, and a checklist to review as you approach closing.

U.S. Financial Literacy and Education Commission

www.mymoney.gov

1-888-My-Money (696-6639)

MyMoney.gov is the U.S. Government's website dedicated to teaching all Americans about financial education. Whether you are planning to buy a home, balance your checkbook, or invest in your 401k the resources on MyMoney.gov can help you.

Federal Consumer Information Center

www.pueblo.gsa.gov

1-800-688-9889

The Federal Consumer Information Center (FCIC) provides free online consumer information. The FCIC produces the Consumer Action Handbook, which helps citizens find the best sources for assistance with consumer issues.

Department of Housing and Urban Development

www.hud.gov

1-800-669-9777

The HUD website offers educational resources on buying and renting homes.