

Debunking seven mortgage myths

By KENNETH POLIN

In stark contrast to a year ago, when interest rates hovered two percent lower, home purchasers now face the increasingly frustrating task of trying to obtain the most competitive mortgage programs.

Here are seven myths which, all too often, undermine those efforts:

• **Myth No. 1: Pick the lowest start rate.** An introductory rate of an adjustable rate mortgage (ARM) is almost always an artificially low rate designed to entice the consumer.

The rate, as adjusted over the term of the mortgage, ultimately will be decided by the index, margin and caps of the program. The index plus the margin determine the fully indexed rate, subject to the periodic and lifetime limits on adjustments, known as caps. Even the annual percentage rate (APR), the cost of the mortgage loan as an annual rate, is often a misleading calculation.

Presume, for instance, that the starting rate is six percent. Within 37 months, during a market of rising interest rates, it would not be far-fetched under most one-year ARMs for the mortgage rate to reach 12 percent. Based on an initial mortgage of \$250,000, mortgage payments under these circumstances would jump from about \$1,500 to \$2,500 per month.

Simply put, a low-rate ARM may become a nightmare of unaffordable payments.

• **Myth No. 2: Fixed rate mortgages are best for everyone.** Depending upon differences in the rates of fixed-rate and ARM programs, it may not be wise to choose a program where the rate remains the same.

The critical question is how long the home purchaser intends on staying in the residence; generally, the longer the stay, the more it makes sense to secure a fixed rate. Although financial considerations may

press for an ARM, psychological comfort may dictate a fixed rate mortgage.

• **Myth No. 3: Do not pay points.** One "point" is equal to one percent of the mortgage amount. Usually, it does not make sense to pay points on a refinancing because points are not tax deductible. However, points usually *are* tax deductible when paid in connection with a purchase.

Since paying points will lower the interest rate, and hence the monthly mortgage payments, paying points becomes attractive when a lengthy period of residence is planned.

• **Myth No. 4: The bigger the mortgage, the better.** Some tax planning professionals recommend seeking the highest mortgage attainable in order to generate the greatest tax deductions.

However, for psychological reasons alone, it may make more sense to limit the financing to permit monthly payments that are more easily made.

Moreover, financing in excess of 80 percent of the value of the property generally results in private mortgage insurance premiums, which may be costly and are not tax deductible.

• **Myth No. 5: Prepay your mortgage.** The popular press raves about the thousands of dollars in interest payments to be saved by prepaying a mortgage. For people who are not careful savers or investors, prepaying a mortgage may be an excellent way to save.

For the sophisticated investor, however, the tax advantages generated by a mortgage

may warrant making only the prescribed monthly mortgage payments and, with surplus funds, making prudent investments.

• **Myth No. 6: Mortgage balances always go down.** Logically, with each mortgage payment, the principal balance declines. In today's market of complex mortgage programs — not necessarily. There are ARMs where the rate adjusts monthly, but where payments adjust annually. Under such programs, if only the scheduled monthly payment is made over a period of rising interest rates, the principal balance of the mortgage will actually increase. Consumer beware!

• **Myth No. 7: Direct lenders deliver the lowest rate mortgages.** Today, a competent mortgage broker usually can deliver the best rates available because of the wholesale pricing afforded by the brokerage's correspondent lenders. Moreover, a mortgage broker owes primary allegiance to its clientele, not any single lender. Accordingly, each loan application should be directed to the lender that can best serve the interests of that particular client.

When you need to find a good mortgage broker, a good place to start your research is the Better Business Bureau.

• **Final advice:** Become well educated about the broad spectrum of mortgage products available today. Also, be sure to choose an experienced mortgage professional to handle your particular financing needs and preferences.

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