

Major Mortgage Mistakes

Just as there is no neighborhood that is right for everyone and no single home that is perfect for every buyer, there is no one mortgage that will be the best for each and every home buyer. Each buyer's situation will be, to some degree, unique, and thus their mortgage needs will vary. This does not mean, though, that the mortgage selection process is an easy one. There are a number of situations where mistakes and errors can--and frequently do--occur. Mistakes made in the mortgage process can cause everything from minor annoyances up to, and including, financial disaster, so the potential for these mistakes should be taken very seriously.

To avoid mortgage mistakes, the very first thing that any home buyer must do is to clearly establish the attitude that they--and only they--will be responsible for the payment of the mortgage. Not the lender, not the Real Estate Agent, not friends or relatives. Therefore, any and all decisions should be first and foremost personal ones, and secondly, rooted in common sense.

Are many home buyers currently making major mortgage mistakes? We think the evidence is fairly clear, that many are, in fact, making mistakes as evidenced by the fact that last year saw the highest level of home foreclosures in history. (Higher than in much deeper and longer recessions, higher than in periods of much higher unemployment). We see this as absolute proof that many home buyers are making big errors as they examine and choose mortgages.

MISTAKE #1: Choosing the Wrong Mortgage

It is easy to make an error here, if only because there is such a vast selection of mortgage plans from which to choose. Common sense, though, should prevail here. For example, choosing a 30-year mortgage when you plan to retire (and move) in 10 years. Securing a fixed-rate mortgage with high closing costs when you are going to be transferred in 2 1/2 years is another example. Another mistake (potentially a budget-busting one) would be to select an adjustable-rate loan (especially in this historically low interest rate environment) when you don't expect your income to take a large jump in the future. Or, perhaps, the biggest "wrong mortgage" of all--getting a large mortgage when you know that 1 of the 2 incomes needed to support it will be going away in the future.

The key to selecting the right mortgage is to find the loan that fits your personal budget and situation, rather than trying--or worse, hoping--to have your budget and situation magically conform to the mortgage. The road to financial ruin is littered with examples of buyers who did not do the research necessary to ensure that they selected a mortgage that was a good fit. Take your time, analyze your situation, get several opinions and use your common sense.

MISTAKE # 2: Letting Qualifying Ratios Get Out of Hand

"The old rules don't apply anymore." We've heard these words so often that it is about to make us crazy. We heard them during the stock market run-up of the 1990s, when stock prices had no connection with reality. We heard the words in 1999 and 2000, when businesses that had no reason for existing drew accolades and admiration from the business press and the American public. Strange that it now looks as though the old rules--like proper valuation and smart business plans--DO apply.

Now we are hearing the same kind of nonsense when people speak about mortgage qualifying. "Oh, that's the way they USED to do it, but things are a lot different now. Mortgage lenders are much more flexible on how much you can afford."

True. But there are many home buyers in very serious financial trouble now, so who was right? For years, you qualified for a mortgage based on some fairly well established ratios. Your total mortgage payment (including principal, interest, taxes and all insurances) should not total more than around 28% of your monthly gross income. Your total debt load, including the mortgage payment, as well as all other debts (car loans, personal loans, credit card payments and any other loans) should be no more than 36% of your total monthly gross income.

Many mortgage lenders have thrown those old ratios out the window, approving household debt ratios in excess of 50% of income. Let's be clear here: If over 50% of your income is going to debt service you will be forced to either live a very shallow life with little or no funds for saving, investment or enjoyment, or, worse, are headed for a financial disaster.

Want the financial aspect of your home owning experience to be as stress-free as possible? Do your best to adhere to the 28% and 36% ratios.

MISTAKE #3: Not Enough Down Payment

Want to really compound mistakes 1 and 2? Get the wrong mortgage (#1), have too heavy a debt load (#2) AND put little or nothing down. Not too long ago, a 20% down payment was fairly normal when purchasing a home. In the last decade the average down payment fell to 10% and recently, to even less. This has been a boon for home buyers, especially those purchasing their first home, but these lower (and, at times, nonexistent) down payments carry with them some real potential downfalls.

As long as real estate values appreciate at the supercharged levels that have in the last couple of years (and virtually NO one thinks they will) there should be no problem for those buyers who have little or no down payment should they want (or need) to sell. Should housing values stagnate, though, or worse, go down, these buyers will not be able to sell their homes without paying for commissions, selling expenses and the like out of their own pocket. These expenses can total upwards of \$10,000 on a \$150,000 home for example. Still owe around \$150,000? Those \$10,000 in expenses will need to come out of your pocket.

Summing Up

How do you avoid these potential costly and/or disastrous mistakes? By preparing yourself as best you can for the mortgage lending process.

- 1) Carefully research the types of mortgages available in your area.
- 2) Spend the time necessary to take a clear look at your income, budget and future plans.
- 3) Tailor your mortgage decision to these factors, rather than just accepting a loan that the lender offers, even if it may not suit your situation.