



A Primer on Mortgage Lending Practices



MBA's Think Tank

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Title: A Primer on Mortgage Lending Practices

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Executive Summary:

Home mortgage lending practices-especially for loans for families with low income or wealth-have come under increasing scrutiny of late. To determine if particular practices or loan terms are unfair or questionable, it is essential to understand their function in the mortgage contract. That is because the way any loan is structured reflects, and affects, the economic interests of both the lender and the borrower.

To provide a source of information for consumers, consumer groups, and other interested parties, the Research Institute for Housing America Trust Fund of the Mortgage Bankers Association asked Professor Raphael Bostic of the University of Southern California to produce a white paper that would clearly and simply discuss the main components of home mortgages and some of the issues that have been raised regarding current practices. The publication "A Primer on Mortgage Lending Practices" is the result of his efforts.

Clearly, the primary defense against predatory lending practices is an informed consumer who understands both the financial arrangement to which she or he is agreeing and what pitfalls to avoid. Informed borrowers help eliminate misunderstandings and lower the chance that families will get into financial trouble after the loan is made. Lenders make profits most readily when a loan performs well, thus avoiding costly disputes and foreclosure actions.

In addition to discussing the basics of such mortgage lending terms such as prepayment penalties, among the most important issues Professor Bostic addresses are:

What determines the cost (the interest rates and fees charged) of a mortgage for the consumer?

- The business costs a lender must cover
- The two major financial risks for which lenders must be compensated
- The role played by the major secondary market players: Fannie Mae and Freddie Mac

How does the individual borrower's financial status affect the cost of the mortgage they are offered?

- The role of credit scores
- Why how much is borrowed and how much income there is to support the loan matters
- The difference in how "prime" and "subprime" loans are priced and why

What things a consumer should do to get the best deal possible, given their financial strength and needs.....

- Looking at the contract interest rate or up front fees alone is not enough

When does it make sense for the consumer to enter into some common, special mortgage arrangements?

- Does the use of a home mortgage for the purpose of debt consolidation make sense?
- Should fee and points be "financed" by the loan itself?
- Should you borrow as much as you can?..... even more than the value of your home?
- Is it always wise to tap into your home equity?

What is the story with special types of home mortgages and practices?

- Balloon mortgages, interest-only loans, and negative amortization
- What is credit life insurance and when is it appropriate?
- Repetitive refinancing and "loan flipping"

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