



Using Ads to Shop for Home Financing

For many homebuyers, shopping to find the best home financing is as important as shopping to find the right house. After all, a small difference in the mortgage rate can make a big difference in monthly payments.

Many consumers learn about available credit terms for new homes from newspaper advertisements. But consumers may not know what to look for when they compare credit terms in home advertisements.

Here are answers to some questions you may have about home credit advertising.

What terms must a home financing ad contain?

There is no federal requirement that ads for homes provide information about credit terms. But the Federal Truth in Lending Act requires that if an ad includes certain credit terms, such as the amount or percentage of the down payment (in a credit sale), the amount of the monthly payment, the length of the loan, or the amount of the finance charge, it also must include all of the following information:

- The amount or the percentage of the down payment (in a credit sale)
- The terms of repayment (i.e., the amount of the monthly payment and the length of the mortgage)
- The rate of finance charge, expressed as the "annual percentage rate."

If an ad includes any interest rate, such as the simple interest rate or rates that apply for a limited period of time, the law requires that the annual percentage rate also be advertised. If an ad says "10% financing," "the equivalent of 6%," or simply "8%," the advertised rate is probably not the annual percentage rate. The actual cost of the credit is likely to be higher. Therefore, you should ask for the annual percentage rate and compare terms.

What is the difference between the annual percentage rate and other interest rates?

The annual percentage rate (APR) includes all the costs of credit; other interest rates do not. For example, the "simple" interest rate is the one usually shown on the mortgage document. It does not reflect additional costs to cover, such items as "points" (fees charged when the mortgage is closed) or mortgage insurance. If an ad does not include the APR, it does not tell you everything you need to know about the cost of credit.

For example, suppose you had to choose between a 9 percent simple interest rate and a 9 percent APR on a 30-year loan. Also suppose the house cost \$110,000 and you made a \$10,000 down payment, leaving \$100,000 to be financed. Because of the small down payment, many lenders would require you to buy mortgage insurance, often costing one half of one percent of the loan balance. With a 9 percent simple interest rate, the extra cost for the mortgage insurance, and other loan origination fees, your monthly payments might be as high as \$841. But with a 9 percent APR, which includes the cost of mortgage insurance and other loan origination fees, your monthly payments should not exceed \$805. The difference between these two rates could be \$36 a month and thousands of dollars over the loan.

What should I look for in ads that offer “creative financing?”

Creative financing plans typically include lower payments in the earlier years of the financing plan, interest rates that can change during the entire term of the loan, or some combination of these features. Look for the following information in the ad, or ask the lender these questions:

- *Will the interest rate or the monthly payments change during the term of the loan?* In some loans, a below-market rate and lower payments apply only for the first few years, but higher rates and payments follow for the remainder of the loan term.
- *How will the new interest rate or the monthly payments be calculated?* The increased rate and payments are stated in advance in some mortgages. In others, they are tied to certain indexes and depend on future market conditions. In these loans, the amount and frequency of the changes in your interest rate and payments also depends on the terms of your loan agreement.
- *Will the advertised monthly payments be large enough to pay off the mortgage?* Some mortgage plans offer low monthly payments even though the interest rate is fairly high. If these monthly costs are not enough to repay the loan amount and the interest charges, the difference may be added to the principal. In some plans, you could owe more at the end of the mortgage term than at the beginning.
- *Will you have to refinance the mortgage after a few years?* If a large or “balloon” payment is due after a few years and you do not have the necessary cash, you may have to refinance the mortgage. If you do refinance and interest rates have risen, you may have to make much higher monthly payments than you had planned.

How can I tell if the advertised credit includes monthly payments or interest rates that will change?

Phrases such as “effective rate,” “adjustable rate,” or “flexible payments” indicate that the credit terms may change. If you see any of these phrases in an ad, find out more about the credit terms. For example, if an ad offers a “7% effective rate,” look for other information, such as the APR, to tell you the full cost of credit.

Where can I get more information about home financing?

While credit advertising can help you compare financing plans, it is important to get more detailed information before deciding on a mortgage, especially if creative financing plans are involved. It may be worthwhile to consult a professional, such as an attorney, accountant, or credit union for help in understanding various home mortgage plans.