

The Worst Loan in America — and Mortgage Companies are Still Pushing It

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As heard on "The Solomon FREE Money Hour" on 97.1 FREE FM with Kerri Kasem

On our website, Under Articles/Newsletters then Top Articles, I wrote an article that talked about the 3/1, 5/1, 7/1, 10/1 Interest only loans. Are these the loans for you? I failed to mention the 1% Option ARM (Adjustable Rate Mortgage) one of the most popular loans in California and high-priced real estate areas. Let me put it to you this way, I would never get this loan for myself unless I had some type of situation happen to me where I needed to get the lowest payment possible or I was about to lose my home.

I can't believe how popular these loans are right now! They call it "The Freedom loan" the "4 pay option ARM" the "Pick a Payment" loan – so many different names but they all can mean one thing – **Trouble!!** I just read an article about this loan and the author called it "The Worst Loan in America" and I concur with that 99% of the time. The reason it is not 100% is because I do realize that some hard-ships happen in people's lives and they don't want to lose their home due to affordability and they need the lowest possible payment to survive, or other extenuating circumstances.

This is the greatest loan in America in order to achieve the lowest monthly payment. For someone who just lost their job and needs to reduce their mortgage payment dramatically, a great loan. For someone who had a tragedy recently happen to them and money is a major problem, this is a great loan! The problem is, is that this loan has potential negative amortization, most likely a pre-payment penalty, and it is an adjustable rate loan. The loan officer will tell you that the payment is fixed for 5 years (which is true),

but the rate is adjustable (which they don't tell you unless you ask).

They conveniently forget to mention to you that the loan has potential negative amortization, if rates go up and if you make the minimum monthly payment each month. The loan balance can actually go up each month if you make the minimum payment. If you ask on negative amortization, they will probably explain to you that there are 4 payment options to make to avoid negative amortization. However, do they tell you that the loan is based on an adjustable rate, unless you ask? They say the payment is fixed for 5 years. Actually, that is close to true. The minimum payment option has a maximum annual payment cap of 7.5% per year. So that means if the minimum payment in year 1 is \$1,000, the maximum the payment can be in year 2 is \$1,075. Remember, the loan accrues interest at the Index (MTA, COSI, and a few others) + a margin of anywhere from 2-3%.

As of this publication, the MTA Index is currently 4.883% and the average margin is about 3-3.5%. Combined: a rate of 7.883%. The current 1 year treasury bill rate is 4.95% and if rates stay the same, then the rate will be 8.03% 12 months from now. Current fixed rates are at 6.25% for zero total costs, points and fees (as of 12-11-06).

The MTA index is an average of the 1 year Treasury Bill over the last 12 months.

A lot of people ask, "What if I do this type of loan on my rental property to keep payments low?" What do you think my answer is? Heck no! Here's why..... Pretend we were in front of the Chicago Board of Trade where they trade Mortgage Back Securities. You're standing there and you're looking at a chart on the History of Interest Rates. You notice that we are at ap-

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proximately 1.25% from the all-time record lows of interest rates. Now, here's my question: WHEN IS THE BEST TIME TO LOCK INTO A FIXED RATE? When rates are at their all-time lows or highs? Obviously, we know the answer. To get an adjustable loan today is not a great decision, unless you can't afford the payment of a fixed. At that point, you have no choice. However, when you read that article "3/1, 5/1, 7/1, 10/1 Interest only loans -- are these the loans for you?" at that point you will understand what may happen to your payment if rates go up in 5 years. I understand wanting positive cash flow on a rental property and keeping your payments low, but at what cost, not being able to afford your payment when rates go up and the 5 yr fixed payment option expires? Think about it!

So here's the bottom line! If someone solicits you over the phone and says we can drop your payment in half, hang up the phone! I only scratched the surface on these loans, I have a lot more info to explain, but for the purposes of this article and to inform our clients of Solomon Financial Mortgage, I think I have addressed some issues that can only be denied, not argued! My favorite line here is: "The sky is blue, now argue with me!" 1% this, 1% that – What is all This I am Hearing About 1% "Why This is the Worst Loan in America" By Fred Solomon, Jr. On the History of Interest Rates Chart, you notice that we are less than one percent from the all-time record lows (only .875 or 7/8%).

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