11/11/2006

The Dangers of Home Equity Mortgage "Loan Flipping"

Taking advantage of home equity has become a very hot market for homeowners in recent years. Homeowners like the ability to take cash out of their home investment for things like home improvement projects, college tuition, and debt consolidation. Unfortunately, every hot market item also attracts scammers, exploiting the naivete and innocence of many borrowers. This is true of home equity loans. If you are in the market for a home equity mortgage, beware of costly "loan flipping" schemes.

Loan flipping is when a lender gets you to pull out your equity by refinancing your home mortgage several times. Your equity is the difference between the total value of your home and the amount you still owe to your first lender for the mortgage. For example, if your home is worth $300,000 and the balance of your mortgage loan is $250,000, you have $50,000 worth of home equity. You may have accrued such equity either by making your mortgage payments every month for several years, or by the influences of inflation on your home value, or by a combination of both. Disreputable lenders will try to persuade you to take advantage of that equity by refinancing your first mortgage, and then to refinance again later.

The way it works is that a lender will convince you that a home equity mortgage would free up some extra cash for your needed projects. That sounds good to you so you take out the second loan. Then sometime later, the lender contacts you again and tempts you with a bigger home equity loan offer, promising you more cash for other needed or desired ventures. You again take him up on the proposition. This may repeatedly happen until either you realize what is going on, or until you can no longer make your mortgage payments and lose your home.

One of the greatest harms of loan flipping to you as a homeowner is that every time you refinance your mortgage, you will be required to pay closing costs and fees, and maybe even additional mortgage loan points (1% of your loan value.) That means each successive loan could cost you up to several thousand dollars in extra charges. Your unethical lender may even charge you a higher interest rate on your home equity mortgage than you paid on your original loan. They will often include pre-payment penalties that will cost you hundreds or thousands each time you refinance before the specified period is over.

In the end, you may pay more in closing costs, fees, and interest than you will actually pull out in cash from your home equity mortgage. You will definitely end up with a lot more debt and will probably have to make mortgage payments for a much longer time period than you initially expected.

Avoiding these types of scams starts by knowing they exist. Be cautious in choosing a mortgage lender. Check his or her history of business practices by contacting the Better Business Bureau. Try to get lender referrals from friends and family to make a good choice. Make sure you feel comfortable with your lender and never let one pressure you into a loan you do not really want.