SECOND MORTGAGE: Is it a good way to get money?

Quite likely, the equity you have in your home represents a larger nest egg than you realize. Your equity is the difference between what you owe on your real estate and what it is worth on today's market. Even if you bought quite recently, the combination of home improvements you have made, general inflation, and housing or mortgage money shortages may have created quite a jump in your equity's worth.

That equity could represent the largest single item among your family's total assets. Yet in the business sense, your equity is financially nonproductive because it doesn't yield interest or profit. It could be a money-wise move for you to put your equity to work more actively.

What are the possibilities?

The equity in your home could be a funding source for a number of things. How about major home improvements? Financing your youngsters' college educations? Helping newlyweds buy their first home? Investing in vacation properties or other real estate? Consolidating debts?

The fact is, unless you sell your property for cash in hand, you cannot realize or spend the equity. Yet, the unrealized equity in your home could well represent impressive borrowing power—the kind of financial leverage that all business ventures count on to expand beyond the limits of current company capital. How can you take advantage of that leverage?

You have three main alternatives, each with advantages and disadvantages. Consider the pros and cons carefully:

1. *Open-end borrowing.* Not all mortgages include this right. Read your original mortgage agreement carefully: If you have the right to re-borrow up to the amount of the original loan, it will be clearly stated. Interest rates on an open-end arrangement vary among mortgages and lenders. A few years ago you could increase your loan to the original amount borrowed and pay interest at the original rate. Or you'd pay the current rate only on the new amount you borrowed. Today, you may run into the common practice of having to pay interest on the full loan at current rates, just as if you were negotiating for the first time. However, if you have a guaranteed low rate, and the amount you can borrow is ample, you have a bonanza! Here are the pros and cons:

Pro: Quite easy to arrange, since the lending institution knows you and your property already. Often a statement of current net worth is all that's required.

Con: Rights to reopen usually are limited to the original loan sum as a maximum. If you originally borrowed 70 percent of the purchase price, and if your property has since gone up substantially in value, then your old 70 percent limit now probably represents a much smaller percentage of the current market value, so it just might not cover your cash needs today.

Con: If you are limited to the remaining term of repayment of both original and new

sums, the monthly payment could rise steeply. Now such terms often are open for discussion. Give it a try, anyway.

2. *Refinancing your present mortgage.* With refinancing, you actually create a new mortgage. During the transaction, you repay the original in full and enter into a separate long-term commitment for the new total at current interest rates. Recently, interest rates have soared. Even if, by rare chance, your mortgage rate is higher than the current rate, you'll probably forfeit a prepayment penalty fee. Such penalties are designed to discourage frequent refinancing by patrons every time the interest rate dips, and the amount you'll have to pay probably will represent a substantial portion of the lender's "lost" revenue as originally projected in the loan agreement. *Caution:* Professional money managers say you should never surrender a low rate for a higher one, unless money is no object. Some more facts to consider:

Pro: Besides getting cash in hand, you often can arrange for lower monthly payments or other changes from the original, such as a longer term—although be aware that such action ultimately costs more.

Con: Today's high interest rates in most cases make it impractical to switch lenders. Chances are, the new lender will quote the highest permissible rate that the transaction can bear.

3. *Placing a second mortgage.* Also called a "homeowner" or "equity loan," a second mortgage is a pledge of your equity, with the property as collateral. It's called a second mortgage because its claim, in case you default, comes after the first mortgager's claim. Incidentally, you needn't be embarrassed by a second mortgage; it's not the sign of an "in hock" household. The second mortgage today has become one of the more flexible sources of large loans and is rapidly growing in popularity and availability. It's something to look into, whatever your needs.

Second mortgages are usually limited to a percentage of your equity. Some lenders will loan up to 75 percent of equity; some up to 100 percent; and a few, even more. How much you can borrow depends on the lender's philosophy, your personal credit standing, and the condition of your real estate.

Pro: You can repay on any mutually acceptable schedule. This can create significant savings on interest, when compared to refinancing the full amount. Also, costs of obtaining the second mortgage loan are minimal or nonexistent. Since the second mortgage does represent a greater risk to the lender he asks a rate higher than for a first mortgage. But the faster you can repay the second mortgage, the greater your savings.

Con: Some "low monthly payment" loans can conceal a *balloon payment* provision—that is, a commitment to pay one or several huge sums near the end of the contract term. It's a practice to be avoided by most people, since a balloon clause could generate future financial problems, or even disaster.

Where can you get a second mortgage?

Second mortgage money is available in many states through regulated agencies. In some states, these agencies include banks; most likely, the agencies are responsible finance and personal loan companies. Recently, mortgage banking firms have developed correspondent arrangements with some finance companies experienced in second mortgage lending. If your mortgage is with a mortgage banker, it's worth inquiring to see if they make such deals. Also, if you are purchasing real estate, sometimes the seller will carry a second mortgage himself. If this arrangement is open to you, it may eliminate the need to borrow on your present real estate.

Sometimes other members of a family may offer to take a second mortgage. Although this could mean a favorable interest rate—say, the going rate they might otherwise be earning in a bank account—borrowing from your family can pose some personal problems. Also, a mortgage with a relative does not insure you that the family will not lose control of the homestead without prior knowledge. As first mortgager, the bank gets first chance at the property in case of default—assuming no prior claims on the property are filed later.

Which method should you use?

Once you've made a psychological commitment to pledge your house—whether through reopening, refinancing, or incurring a second mortgage—you'll still have to shop carefully to get the very best financial deal. This takes careful calculation of a number of variables. Take nothing for granted when you check out these corresponding components of your total financial package:

- How much do you want to borrow? Determine the amount of money you really need. Don't endanger the project by seeking too little, but don't overextend yourself, either.
- How fast must you pay off the loan? Which do you value more: the total savings in shorter term interest costs or the easy monthly payments? Do you need one lump

continued

Second mortgage

um, or will you be meeting a series of scattered payout dates? If the latter, you'll save on interest by arranging for a partial draw against the grand total approved for the loan.

• Are there better sources of cash available? Some life insurance policies offer extremely low rates (five or six percent) against your built-up cash value. Also, the government guarantees education and FHA loans, so there's no need to pledge the home. Often FHA Title I home improvement loans will meet your needs. (You may not qualify for these loans, however. For example, there is an economic need test for the education loans. And for the Title I loans, you must be able to show that the money is used strictly for home improvement or remodeling.)

• What are the best interest rates available? This applies not only among individual lending institutions, but also to categories of lenders. Generally, banks and savings and loan associations offer the lowest rate, with commercial second-mortgage agencies slightly higher, and signature-loan offices highest of all.

• What extra costs will there be? Total up the fees, points, and service charges—all are disguised interest paid in advance. One *point* refers to one percent of the total loan as a prepaid fee.

• Are there special costs? How about a prepayment penalty? Or balloon payments?

• What are the repayment periods? The faster you can pay back, the less you'll pay in interest overall. Don't forget, though, that persistent inflation means that you'll be repaying long-term debts in cheaper dollars in the years to come. What appears to be a steep rate today actually may work out to a lot less in inflated dollars in the years to come.

When you're setting up the terms, keep a safety margin for unexpected events, and even though it costs a little more, consider longer terms. You can always send more than the scheduled payment, and by doing this you can either retire your loan earlier (and thus save on over-all interest dollars) or build a reserve for an installment you may want to miss later on. ■

TO BORROW $5,000
Which method suits your needs?

Assume: Your original loan of $20,000 for 20 years at 6¾ percent interest, compounded monthly, has twelve years remaining. Your monthly payments on that loan are $152.08, and your equity after eight years is $5,003.52. You now owe, $14,899.52.

	Open end*	Refinancing	Second mortgage
Lending terms	6¾% on original mortgage, 9¼% on new loan, both for 12 years	combines old and new debt at 9¼% for 12 years	6¾%, 12 years on original mortgage; 18% annual percentage rate, 5 years on second mortgage
Original mortgage at 6¾%	$20,000 00	$20,000 00	$20,000 00
Equity after 8 years	5,003 52	5,003.52	5,003 52
Amount borrowed	5,000 00	5,000.00	5,000.00
Points after new loan (estimated)	NONE	$500 00	NONE
Monthly payments			
First mortgage	$152 08 x 12 yrs = $21,899.52		$152 08 x 12 yrs = $21,899 52
New loan	$57 61 x 12 yrs = $8,295 84	$230 44 x 12 yrs = $33,183 36 (combines old & new)	$126.97 x 5 yrs = $7,618.20 (second mortgage)
Total pymts. per mo	$201 69 for 12 yrs	$230 44 for 12 yrs	$279.05 for 5 yrs $152 80 for next 7 yrs
Total payments	$30,195 36	$33,683.36	$29,517.72