FIVE DEBT TRAPS
FIVE SMART SOLUTIONS

CREDIT LIMIT
55

1. High-Cost Credit Cards
2. Financing an Expensive Car
3. Avoiding Excessive Student Loan Debt
4. Buying a Big House
5. Borrowing on a Home Equity Line of Credit

State of Maine | Bureau of Consumer Credit Protection
Department of Professional and Financial Regulation

DOWNEASTER COMMON SENSE GUIDE

FIVE DEBT TRAPS
FIVE SMART SOLUTIONS

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Maine Bureau of Consumer Credit Protection

Toll-free Maine Consumer Assistance
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TTY users call Maine relay 711

Maine Foreclosure Prevention Hotline
1-888-NO-4-CLŌZ
(1-888-664-2569)

www.Credit.Maine.gov

The Maine Bureau of Consumer Credit Protection was established in 1975 to enforce a wide variety of consumer financial protection laws, including:

-Consumer Credit Code
-Truth-in-Lending Act
-Truth-in-Leasing Act
-Fair Credit Reporting Act
-Fair Debt Collection Practices Act
-Debt Management Services Act
-"Plain Language Law"

The Bureau conducts periodic examinations of licensees and registrants to determine compliance with these laws; responds to consumer complaints and inquiries; and operates the state's foreclosure prevention hotline and housing counselor referral program. The Bureau also conducts educational seminars and provides speakers to advise consumers and creditors of their legal rights and responsibilities.

William N. Lund
Superintendent
November 2019

DOWNEASTER COMMON SENSE GUIDE:
Five Debt Traps, Five Smart Solutions
By Adam Poulin and David Leach, MPA
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Maine residents can obtain additional free copies of this booklet by contacting the Bureau of Consumer Credit Protection at 207-624-8527 or toll-free at 1-800-332-8529. Non-Maine residents may purchase the publication for $6 per copy, or at a volume discount of $4 per copy on orders of 50 or more. Shipping fees are included in the prices listed.

Here at the Bureau of Consumer Credit Protection, we tend to hear from consumers only when things have gone wrong:

- when they are in debt with high-interest personal loans and high-balance credit cards owed to out-of-state banks;
- when they bring home a new car and then realize they were "sweet-talked" into purchasing or leasing a vehicle that's too expensive for them;
- when they are facing a mountain of student loan debt;
- when they realize their mortgage payments on a big house are unaffordable; or
- when they have a burdensome second mortgage on their house and must pay back the balance on a HELOC (home equity line of credit) after they spent the money on items such as vacations that did not increase the value of their homes.

In this booklet, *Five Debt Traps, Five Smart Solutions*, we discuss the five areas listed above, why it's easy to incur debt quickly, and how difficult it is to pay all that money back.

When used in moderation and as part of a well-planned household budget, these five areas of financial services can constitute necessary components of modern life. It's very difficult to get by these days without a credit card, for example, and many of us strive to be gainfully employed so we can afford a car, and later on, a house of our own. College costs have gone through the roof, and most of us have to borrow some amount to attend an institution of higher learning. And if you have a home and have worked to gain some equity, it's tempting to respond to solicitations from lenders to "tap into" some of that equity with a line of credit secured by the home.

Debt is an emotional issue, and questions about existing obligations or taking on new debt can lead to heated family debates. In this booklet, however, we have endeavored to take the emotion out of these family economics discussions, and apply common sense facts, figures and viable alternatives to incurring household debt.

With this booklet, you will learn to responsibly select and utilize plastic (credit cards); carefully shop for financing on a new or used motor vehicle; make your college choices with your head and not your heart; and learn about financing secured by your home – both the initial purchase and first mortgage, and subsequent second mortgages or home equity lines of credit.

We at the Bureau like to remind Maine residents, "Think Before You Borrow!"

Adam Poulin	David Leach, MPA
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I. Personal Loans and Credit Cards

Borrowing is a numbers game. The Annual Percentage Rate (APR)* is the annual cost of credit expressed as a percentage rate. It's designed to allow you to compare one credit product to another. Don't judge credit products solely by the interest rate. That number does not include additional costs to borrow. Besides charging interest, creditors may charge you processing fees, underwriting fees or points. The APR factors in these costs of borrowing and allows you to make an "apples to apples" comparison.

Lenders establish interest rates based on the risk of the loan to the lender. The greater the risk of non-payment, the higher the APR charged to the borrower. This is referred to as risk-based lending. Risk-based lending often takes into account two primary factors: the borrower's credit rating and the opportunity to collateralize the loan. If a borrower has a poor credit rating, no amount of collateral may attract a lender. If a borrower has an excellent credit rating, a lender may grant a so-called personal loan with no collateral. In these transactions, the borrower's signature alone is security for the loan.

Lenders are more comfortable making loans when borrowers pledge a vehicle or property as collateral. Collateral lowers the lender's risk. The lower the risk of loss to the lender, the lower the APR should be. If the borrower defaults, the lender may take possession of the collateral, auction it off and apply the sales proceeds toward the loan balance.

APRs on unsecured personal loans can range from around 11.40% to more than 30%, depending on the borrower's credit rating as represented by a credit score. Lenders use credit scores to measure lending risk. Credit scores are not created by the big-three credit reporting agencies (CRAs). Rather, credit scores are created by data analytics companies — such as FICO — hired by the CRAs to analyze the consumer information they have on file. Typically, a credit score is a number between 300 and 850 assigned to each CRA consumer file. The higher the credit score, the lower the expected risk to the lender, which results in a lower APR.

Credit Cards

Financial institutions (banks or credit unions) issue most credit cards. The funding mechanism for a credit card is a line of credit. This means you can make purchases until you reach a pre-determined credit limit.

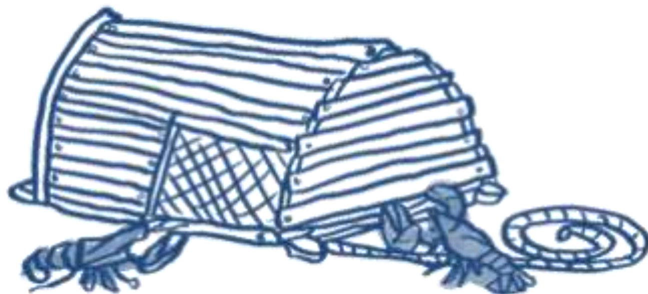
Credit cards are an expensive way to borrow. Most credit cards are unsecured loans, which pose a greater risk to a lender. Because of the

*Bolded words and phrases are defined in the glossary, starting on page 15.

increased risk, the APR is generally higher on unsecured loans. For high- risk consumers, some lenders offer products called secured credit cards. Secured credit cards are tied to a deposit account holding a certain amount of money. For first-time borrowers with a limited credit history, or consumers just out of bankruptcy, secured credit cards may be the only type of credit card available. Used responsibly, they can be an effective way to establish a good credit history.

How do credit cards become debt traps for consumers? First off, when the economy is strong, credit cards may be easy to get. Credit card companies may offer credit cards to you, even if you don't realize you are applying for credit. Years ago, a credit card purchase required a signature. These days, you only need a "swipe." The convenience of a credit card seems disconnected from reality. A recent study showed consumers using credit or debit cards spend more than consumers using cash when making purchases.[1] Cash is real, and handing over tangible money makes more of an impression on the buyer.

Besides the disconnect from reality credit cards provide, some cardholders may experience a disconnect between their credit card purchases and the next month's credit card bill. Many folks make only a minimum payment each month. Some miss payments entirely.



Skipping a monthly credit card payment is a poor option. Not only will the cardholder incur late fees, but also failure to make a payment on an obligation date creates a delinquency notation on the cardholder's credit report.

Say you have a maxed-out credit card with a $10,000 credit limit at an 18% APR. Making only the minimum monthly payment is not a good idea. Depending on the card, minimum payments are usually around 2-5% of the card's outstanding balance. On a card with a $10,000 balance, at a 4% minimum payment, the first month's payment would be $400. As the balance decreases, the minimum payment also decreases. Making only the 4% minimum payment, it would take more than 10 years to pay off the card's balance, at a cost of more than $5,000 in interest.

Winning The Personal Loan & Credit Card Game

If you choose to use a credit card, follow these five simple rules:

1. Choose a card with a low APR — at the writing of this guide, interest rates are very low. Cards holding an APR exceeding 25% are too high. Shop around to find one with a 9.9% APR or lower. Make sure to talk with local credit unions and banks.
2. Select a card with no annual fee — Some

[1] Retrieved from https://www.forbes.com/sites/billhardekopf/2018/07/16/do-people-really-spend-more-with-credit-cards/#22d5db901c19

credit card issuers assess an annual fee even if you do not use the card. There are many cards available without fees, so be smart and shop around.

3. Reserve the use of your credit card for responsible purposes such as travel, emergencies, and reasonable/practical online purchases.
4. Pay the card's balance in full each month to avoid finance charges. If you can't pay off the balance, put the card away and don't use it again until the balance is under control.
5. Pay cash or use a debit card for purchases whenever possible.

Making impulsive purchases and failing to pay the card's balance at the end of each billing cycle (the period between when bills are due) or during the card's grace period (a set length of time after the due date during which payment may be made without penalty) is a path to financial problems.

There are many other forms of stored-value instruments available, in electronic or plastic formats, some of which can be purchased at your local grocery, drug, department store, or online. Be aware, however, that many of these products charge fees for purchase, activation, and use.

In the 21st Century, one could argue possession of at least one or two credit cards is essential. When traveling, you get a lower room rate when booking (online or via telephone) in advance, rather than showing up unannounced at the front desk, hoping there is still a room available. Rental vehicles? Forget about driving off in one without producing a credit card at the counter.

Bringing large amounts of cash with you when traveling is not recommended. Cash can be lost or stolen, with little or no chance for recovery. Purchasing with plastic is much safer. Credit cards can also come in handy in emergency situations, such as when you need a roadside car repair.

Some credit card companies offer reward packages. Many offer a certain amount of cash back as a reward for choosing their card. When looking into getting a new credit card, be sure to look for deals that will be beneficial to you.

Not all credit cards are equal. APRs vary, and card annual fees can range from $25 to more than $100. Consumers with average to high credit scores may qualify for credit card products offered by Maine financial institutions. According to a recent survey by Creditcards.com, the national average for recently-approved credit cards is 17.72% APR. Smart shoppers can often find local banks or credit unions offering much lower rates. Some credit card issuers offer promotional periods of 0.00% APR for an initial period, usually between 6 and 18 months. After that initial period, however, the APRs adjust to the "fully indexed rate," often based on the Wall Street Prime Rate plus 10, 12 or 15 percent. If the index rate was 5.5%, that could mean an APR of 15.5%, 17.5%, or 20.5%.

II. Auto Buying and Financing

Buying a vehicle is one of the largest purchases most consumers ever make. Never hurry when making the decision to buy and finance such a significant item. When buying a new or used vehicle, you want it to be exactly what you're looking for, such as a certain color or capacity; two- or four-wheel drive; or superior economy. Get an insurance quote before buying — the price of auto insurance can vary widely depending on the driver, the vehicle, your place of residence, and other factors. Don't forget to consider the registration costs associated with new(er) vehicles when budgeting for your purchase.

When you drive out of the lot you want to be smiling, so don't rush.

- Test drive the car under varied road conditions—on hills, highways, and in stop -and-go traffic.
- If it's a used car, ask for the car's maintenance record from the owner, dealer, or repair shop.
- Determine the value of the vehicle before you negotiate the sale. Check the National Automobile Dealer's Association (www.nadaguides.com), Edmunds (www.edmunds.com), Kelley Blue Book (www.kbb.com), and Consumer Reports (www.consumerreports.org). Your financial institution may also be able to help you determine your vehicle's value.
- Research the upkeep costs for the model you're interested in, including the frequency of repairs, and maintenance costs.
- Examine the car using an inspection checklist. You can find checklists in magazines, books, and on websites that deal with used cars.
- Check whether there are any unrepaired recalls on a vehicle. With the vehicle's VIN, you can check at safercar.gov or by calling the National Highway Traffic Safety Administration's Vehicle Safety Hotline at 1-888-327-4236.
- Consider hiring an independent mechanic to inspect the car before you buy. If the seller is reluctant to allow you do that, there might be a reason why.

Financing a Vehicle

You have two choices: pay in full or finance over time. Financing increases the total cost of the car, because you're also paying for the cost of credit, including interest and other costs. Consider how much you can put down, the monthly payment, the financing term, and the APR. Rates are higher on used cars than new ones.

Dealers and other finance sources offer a variety of financing terms. Shop around, compare offers, and negotiate the best deal you

can get. Don't let yourself be influenced by flashy advertising, and be cautious about special financing offers. They sometimes require a big down payment and feature high APRs. If you agree to financing that carries a high APR, you may be taking a big risk. Consider making a 10-25% down payment. A larger down payment helps lower monthly payments, and total interest charges. If money is tight, consider paying cash for a less expensive car.

If you decide to finance, make sure you understand the financing agreement before you sign any documents. Ask yourself:

Annual Gross Household Income	Monthly Gross Household Income	Recommended Max. Monthly Payments
$15,000	$1,250	$150
$20,000	$1,667	$200
$25,000	$2,083	$250
$30,000	$2,500	$300
$35,000	$2,917	$350
$40,000	$3,333	$400
$45,000	$3,750	$450
$50,000	$4,167	$500
$55,000	$4,583	$550
$60,000	$5,000	$600
$65,000	$5,417	$650
$70,000	$5,833	$700
$75,000	$6,250	$750
$80,000	$6,667	$800
$85,000	$7,083	$850
$90,000	$7,500	$900
$95,000	$7,917	$950
$100,000	$8,333	$1,000
$110,000	$9,167	$1,100
$120,000	$10,000	$1,200
$130,000	$10,833	$1,300
$140,000	$11,667	$1,400
$150,000	$12,500	$1,500

- What is the price you're paying for the vehicle?
- How much are you financing?
- What is the APR (a measure of the cost of credit, expressed as a yearly rate)?
- How many payments will you make, and how much is each one? Can you afford that amount each month?
- What is the total cost over time — the sum of the monthly payments plus the down payment?

Bureau staff recommend devoting no more than 12% of your household's monthly gross income (income, before taxes) to a monthly vehicle payment (see chart to left).

Sale prices of cars, mini vans, trucks and SUVs are increasing in price at a rate much higher than inflation. Ten years ago, a Ford F-150 Reg Cab XL sold for a **Manufacturer's Suggested Retail Price ("MSRP")** of $18,275. In 2019, similar trucks retail for almost $30,000. It can be easy to get approved for an auto loan with a monthly payment that could crush your budget. Auto loans terms generally range from 24 to 84 months (two to seven years).

Purchasing a vehicle is a major decision. Always make sure you're fully prepared before visiting a dealership. The salesperson may try to draw you into negotiations before you are ready. Don't go to the dealership if you're hungry, tired, in a hurry, or not capable (on your own) of reading *and* understanding what you're signing.

Don't sign an authorization or credit application — or provide your social security number — unless you're serious about

applying for a loan. You shouldn't have to sign a credit application or provide your social security number to simply test-drive a vehicle. If the salesperson tells you that's a requirement or tries to rush or pressure you about any aspect of the deal, politely WALK AWAY.

In Maine, there is no right of rescission on the purchase of a vehicle. If you buy a vehicle, you can't simply change your mind and bring it back. Unless you have something in writing from the dealer indicating otherwise, when a dealer runs a program where you can "return the vehicle," it's an offer only to exchange for another vehicle in their inventory — not the ability to walk away from your current contract, and not a refund of your purchase price.

Tips For Good Credit

There are no secrets or shortcuts to building a strong credit score. Follow these tips:

- Pay your bills on time, every time;
- Don't come close to "maxing out" your credit cards;
- Don't close old accounts on which you have a long history of on-time payments; and
- Apply only for credit you need.

Down Payment Interest Savings on a Six-Year Loan

	20% Down	0% Down
Sales Price	$20,000.00	$20,000.00
Down Payment	$4,000.00	$0.00
Loan Amount	$16,000.00	$20,000.00
Monthly Payment	$280.53	$350.66
Total Interest Paid	$4,198.29	$5,247.52

Total Life of Loan Interest Savings:
$1,049.23

This table illustrates the savings in interest expense between a 20% down payment loan and a 0% down payment loan. In this example, the APR is 8% with a loan term of 72-months.

Since you must repay the vehicle's purchase price plus interest charges, save up for a sizeable down payment. Remember these seven facts about vehicle down payments. The larger your down payment:

- The *Less* you will need to borrow;
- The *Less* your loan's interest costs will be;
- The *Smaller* your monthly payment will be;
- With a *Larger* down payment, you may qualify for a lower APR;
- The *Quicker* you may be able to pay off that vehicle loan;
- The *Greater* likelihood your vehicle will be worth more than your loan's balance the entire term of that loan; and
- The *More* money you will have in your monthly budget.

Eight Questions to Ask Before Buying a Vehicle

1. Do I really need a new vehicle?
2. Is my current vehicle reliable, and not costing me too much in the repair shop?
3. What is the monthly cost of my current vehicle compared to the estimated cost per month of the vehicle I'm thinking about buying?
4. What would this new monthly payment do to my budget?
5. Do I have major expenses on the horizon, such as kids' college costs, funding a retirement account, or home maintenance?
6. Is this vehicle I am considering purchasing filling a "Want," or is it a "Need?"
7. How much do I owe on my current vehicle?
8. Is saving up and paying cash for 100% of the purchase price an option?

Don't hurry, take your time, make a sensible and informed decision.

III. Excessive Student Loan Debt

For many, graduating from high school and moving on to college is an important step toward becoming an adult. It's often the first time students move out of their parents' homes and begin living on their own. Given the costs of college, students and their parents may face the need for student loans.

Taking out a loan is a big decision. Take your time to decide — you could be paying that loan off for 10 or more years. Understand types of loans available. Each student's situation is unique. Common federal student loans include:

- Direct Subsidized Loans — Loans made to eligible undergraduate students who show financial need, to help cover the costs of higher education at a college or career school.
- Direct Unsubsidized Loans — Loans made to eligible undergraduate, graduate, and professional students, but eligibility is not based on financial need.
- Direct PLUS Loans — Loans made to graduate or professional students and parents of dependent undergraduate students to help pay for education expenses not covered by other financial aid. Eligibility is not based on financial need, but a credit check is required. Borrowers who have an adverse credit history must meet extra requirements to qualify.
- Direct Consolidation Loans — Loans that let you combine all your eligible federal student loans into a single loan with a single loan servicer.. Although it sounds like a great idea, do your research if you are considering consolidation. You may lose some consumer rights and protections that attach to the original loans if you consolidate with a new lender.

State	In-State Tuition	Out-of-State Tuition	On-Campus Living Costs	Off-Campus Living Costs
Maine	$6,722	$21,295	$10,320	$7,557
New Hampshire	$10,231	$23,041	$11,971	$11,258
Vermont	$12,770	$32,401	$12,257	$10,649
Massachusetts	$8,585	$26,064	$14,320	$11,171
U.S. Average	$5,858	$17,350	$10,241	$9,592

This table illustrates the difference between average in- and out-of-state tuition, and on- or off-campus living costs for undergraduates as of August 2019. Source: www.collegetuitioncompare.com/compare/tables/.

Only accept the loans you need. You'll have to repay them once you're out of school. The amount you need to borrow can depend a lot on where the school is located. The College Tuition Compare website (https://www.collegetuitioncompare.com/compare/tables/) lists every state's average in-state, out-of-state, private, on-campus, and off-campus expenses. In some cases, out-of-state costs are almost double in-state costs (see table for northern New England states on previous page).

Paying more for college does not always improve your chances of landing a better job when you graduate. Do some research. Make sure your school is the right fit for you, both educationally and financially. Find a school that fits your expected major.

Getting an idea of your future income is also important. Starting salaries vary widely depending on career path. It's worth thinking about how the amount of your loan will affect your future finances. Ideally, your student loans should only take up a small percentage of your income after your graduate.

Minimizing Student Loan Payments

Once you've decided on your school and figured out how much money you need to borrow, you'll need to sign a promissory note — an agreement to repay your loan. It's important you keep a copy for your records. The promissory note contains the loan's terms. If you have already signed for student loans and you don't know any of the above information, you can see the details of your own federal loans on the National Student Loan Data System website (https://nslds.ed.gov/npas/index.htm).

Loan terms (lengths of time to repay) can vary, depending on what the lender offers (for example, 10 vs. 20 years). This impacts your interest rate and your monthly payment. When you sign for the loan, you may be tempted choose the option with the lowest monthly payment. However, a low monthly payment doesn't necessarily equal a cheaper loan.

Let's say you have $100,000 in student loans at a fixed interest rate of 6.8%. Paying off that loan in 10 years would require a $1,150 monthly payment, with $41,060 in total interest. Take the same loan and extend the term to 20 years. Your monthly payment goes down to $763, but the total interest cost rises to $85,860 — $44,740 more than repayment over a 10-year term.

Fell Behind on a Federal Loan?

If you don't pay the full payment due on time or if you start missing payments — even one — your loan will be considered delinquent and late fees may be charged to you. If you can't make your payments, contact your loan servicer immediately for help. Your servicer can offer you temporary and long-term options, such as changing repayment plans, deferment, forbearance, and loan consolidation.

For more information on federal student aid, visit:

studentloans.gov

If you are more than 90 days delinquent on your student loan payment, your loan servicer will report the delinquency to the three major national CRAs. This will lower your credit score and negatively affect your finances.

If your loan continues to be delinquent, the loan may go into default. The point when a loan is considered to be in default varies depending on the type of loan you received. If you default on your federal student loan, the entire balance of the loan becomes due immediately. This is called acceleration. Once your loan is accelerated, you no longer have access to deferment or forbearance options or to a choice of repayment plans. In addition, if you do not make repayment arrangements with the holder of your loan (the U.S. Department of Education, a guaranty agency, or the school that made the loan) and comply with the terms of the repayment arrangement, your loan holder may place your loan with a collection agency.

If your loan is placed with a collection agency, you will be responsible for costs incurred by your loan holder to get payment. The holder of your loan can take other actions to collect as well, such as wage garnishment or tax refund withholding, without going to court. For more information, visit https://studentaid.ed.gov/sa/repay-loans/default.

IV. Home Ownership

Owning a home can give you stability, security and protection from rising housing costs. Homeowners get tax benefits. And when you finish your mortgage payments, you'll own a home you can sell or pass along to loved ones after your death.

But it's a big responsibility. When you own a home, you pay for repairs, along with any property taxes, insurance, and homeowners association dues that apply. If you want to move, you normally try to sell your home first.

If you can answer "yes" to the questions below, you're probably ready to buy your own home:

- Do you have at least two years of regular, steady income?
- Is your income reliable?
- Do you plan to remain in the area for at least a few years?
- Do you have good credit?
- Do you have just a few long-term debts, like car payments?
- Have you saved money for a down payment?
- Can you pay a mortgage every month?
- Can you pay other costs, like insurance and taxes?
- Can you set aside money for other costs of home ownership, like closing costs, moving costs, new furniture, repairs, and home improvement?

Save a Down payment

Most lenders won't lend you the full price of a home. They want you to come up with some of the money yourself. It can be hard to save up a down payment. But a large down payment can help you get a mortgage and reduce the interest rate you pay.

The smallest down payment is usually three-and-a-half percent (3.5%) of the home's price. Many mortgage lenders prefer you put at least five percent (5%) down. Imagine you want to buy a home with a $100,000 sale price:

- A 3.5% down payment is $3,500;
- A 5% down payment is $5,000;
- A 20% down payment is $20,000.

If you can't afford a down payment of 20%, your lender may make you pay for mortgage insurance. That increases your monthly costs.

Check Your Credit

To get a mortgage, you need good credit. For some loans, lenders want you to have a minimum credit score of 620, unless you have a large down payment.

Visit www.AnnualCreditReport.com or use the automated phone system at 1-877-322-8228 to get a free copy of your credit report from the three nationwide credit reporting agencies. You can receive a free credit report from each one every 12 months.

Get Ready to Shop Around For a Home Loan

Choosing the type of mortgage you'll use to pay for your new home is an important decision. You can start by looking around for a network of people and information you trust to help you through the process. And you can start gathering facts about your finances, so you'll have them ready at your fingertips.

To find the best mortgage deal, it's important to shop different lenders. To learn average mortgage rates for a range of different lending products, review the Freddie Mac Primary Mortgage Market Survey: http://www.freddiemac.com/pmms/; it is the go-to source for weekly mortgage rate comparisons.

Bi-Weekly Mortgages

A bi-weekly mortgage is a mortgage in which once every 14 days (two weeks), you make one-half (1/2) of your monthly payment. With 52 weeks in a year, that's 26 half-payments, or 13 full payments each calendar year. Because you are paying the equivalent of the extra month's payment each year, a 30-year bi-weekly mortgage will be paid off in about 25 years, a 20-year mortgage in about 17 years, and so on (see table below). If you can afford to make one extra mortgage payment each year, this may be a viable option for you.

Underwater?

If you push your financial limits, you may struggle to make mortgage payments. Don't let your household budget become unsustainable.

If you default on your home mortgage payments, you risk foreclosure. Even a few late mortgage payments can have a negative impact on your credit, affecting your ability to qualify for more credit for years. If you find yourself facing foreclosure, contact the Bureau of Consumer Credit Protection foreclosure hotline at 1-888-NO-4-CLŌZ (1-888-664-2569). The Bureau will take your information and connect you with a Maine-based HUD certified housing counselor, at no charge.

Loan Amount	Loan Term	APR	Payment	Pay Off Length	Interest Paid
$100,000	30-year Monthly	5.50%	$567/month	30 years	$104,404
$100,000	30-year Biweekly	5.50%	$284 every two weeks	26 years	$83,652
$100,000	15-year Monthly	5.50%	$817/month	15 years	$47,075
$100,000	15-year Biweekly	5.50%	$408 every two weeks	13.5 years	$41,012

This table illustrates the total cost difference between monthly and bi-weekly payment schedules for sample 15- and 30-year mortgages with otherwise similar terms.

V. HELOCs and HECMs

Home equity lines of credit ("HELOCs") allow consumers to access a revolving line of credit (secured by their house) which draws down all or part (depending on the lender's program) of the equity in their homes. Once approved, consumers can access this line of credit though special paper checks or electronic access devices to pay for items such as home repairs or remodeling, children's college expenses, debt consolidation (credit cards, car loans, etc.), vehicle purchases, and even personal entertainment. The larger the balance owed, the greater the monthly payments.

HELOCs generally feature adjustable rates, and renew as the lender evaluates the borrower's financial position. In most cases, interest is deductible. Check with your tax professional for more information on interest deductibility.

People who overuse HELOCs to fund lifestyles above their financial means are often faced with large debt in addition to the amount owed on their first mortgages. Some find themselves struggling in a negative equity position (*i.e.*, they owe more on their home that the house is worth).

On a house, as you make mortgage payments you gain equity. The more payments you make, the greater your equity position. Buying a home provides shelter, but in times of rising home values, it's also a wise long-term investment for most people.

Equity

Home equity is the difference between the appraised value of the home and what you owe on any mortgages or other debt against the home. If you've owned your house for many years, it could be worth more than you paid to buy it.

Example 1: If you own a house worth $100,000, but owe $75,000 on a loan against that house, the house represents $25,000 of equity ($100,000-$75,000=$25,000).

Example 2: If you own a house worth $100,000, but owe $125,000 on a loan against that house, the house represents -$25,000 of equity ($100,000-$125,000=-$25,000).

Reverse Mortgages

The **Federal Housing Administration's (FHA's) Home Equity Conversion** Mortgage (HECM), better known as a reverse mortgage, has features different from those of a standard loan. Instead of making monthly payments to a lender, homeowners receive payments from a servicer. These payments are based on several factors, including the homeowner's age and the equity position of their home. Consumers can receive a lump sum payment, or a line of credit and then monthly payments similar to an annuity until the line of credit reaches $0.

Reverse mortgages do not have to be paid back until the borrowers die, vacate their home, or fail to meet all conditions required by the terms of the reverse mortgage contract. *Reverse mortgage borrowers are responsible for paying property taxes, homeowner's insurance, and all utility bills.*

Federal law requires potential reverse mortgage holders to complete a brief counseling session — often by phone — before agreeing to a HECM. The counselor advises the borrower of the fees and other costs associated with reverse mortgage products. Ideally, reverse mortgages allow seniors to remain in their homes and draw down their equity to meet their financial needs when their retirement income is not enough to maintain home ownership.

To locate a HECM counselor, contact the U.S. Department of Housing and Urban Development at

1-800-569-4287

The National Council on Aging offers free information on reverse mortgages, including a downloadable booklet called

"Use Your Home to Stay at Home"

To contact the National Council on Aging, call 1-800-510-0301 or visit: https://www.ncoa.org/

Three Responsible Ways to Use **Your Home's Equity**

1. Making major home improvements that will increase the property's value.
2. Paying for college tuition or expenses for yourself or a child.
3. Investments yielding a greater return than the HELOC's interest rate.

Three Ways to Misuse Your **Home's Equity**

1. Purchasing depreciating value items like vehicles, ATVs or snowmobiles
2. Funding vacations
3. Retail purchases like buying expensive meals, clothes and gifts

Glossary of Common Credit Terms

Acceleration: When a lender requires a borrower to repay all of an outstanding loan, because certain requirements were not met.

Annual Percentage Rate (APR): The total cost (including prepaid finance charges and fees) of consumer credit, expressed as a yearly rate

Bankruptcy: A legal status of a person who has applied to federal court to discharge debts they cannot pay.

Borrower: The person who receives – and must repay – a loan.

Collateral: Something pledged as security for the repayment of a loan, to be forfeited in the event of default.

Consolidation: The action or process of combining several loans into a single loan obligation

Consumer: A buyer of a good or service.

Credit Reporting Agency (CRA): Any person or company that engages in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties. The three largest agencies are Equifax, Experian and TransUnion.

Credit Score: A credit score, ranging from 300 to 850, that is used by all three major credit reporting agencies. Higher scores denote better credit standing and vice versa.

Default: Failure to make a payment on an obligation when due.

Deferment: A temporary period in which the borrower is not required to make payments.

Delinquency: Failure to make a payment on an obligation date when contractually agreed.

Down Payment: An amount or percentage of the sales price that a consumer pays up-front before financing the balance of the sales price. Down payment by a borrower lower risk to lender.

Equity: A home's appraised value minus what the homeowners owes on any mortgages and liens.

Federal Housing Administration (FHA): A US government agency that is part of the Department of Housing and Urban Development (HUD). The FHA is not a lender but instead provides mortgage insurance on loans made by approved lenders underwritten according to FHA guidelines.

Finance Charge: Interest paid expressed in dollars and cents.

Financial Institution: Any person doing business as: (1) a bank (except bank credit card systems); (2) a broker or dealer in securities; (3) a money services business; (4) a telegraph company; (5) a casino; (6) a card club; and/or (7) a person subject to supervision by any state or federal bank supervisory authority.

Forbearance: A postponement of payment on a loan for reasons such as poor health or financial hardship. Forbearance is typically granted when the borrower does not qualify for a deferment. Interest continues to accrue during forbearance.

Foreclosure: The legal process required for a lender to take ownership of a home pledged as collateral. Maine is a judicial foreclosure state, meaning a lender must go to court in order to complete a residential foreclosure.

Fully Indexed Rate: Is a variable interest rate that is calculated by adding a margin to a specified index rate. For example: The Wall Street Prime Rate plus 5%.

Grace Period: A period of time between the monthly payment due date and the date by which a late fee may be assessed.

Gross Income: Total income before taxes or other deductions.

Home Equity Conversion Mortgage (HECM): A program in which homeowners 62 or older receive funds in exchange for equity in their home.

Home Equity Line of Credit (HELOC): A loan in which the lender agrees to lend up to a certain amount, in which the collateral is the borrower's equity in their home.

Interest Rate: The rate a lender charges to borrow money.

Lender: An individual or entity that makes funds available for consumers to borrow.

Line of Credit: A loan agreement in which a financial institution allows a customer to borrow funds up to a specified amount. Credit cards, home equity line of credit (HELOCS) and checking account overdraft protection lines are examples of lines of credit.

Loan Servicer: A company that collects a consumer's monthly payment and forwards the principal and interest to the holder of the promissory note.

Loan Term: The period of months or years within which all payments on a loan must be made.

Manufacturer's Suggested Retail Price (MSRP): The price an automobile manufacturer suggests a vehicle be sold for.

Mortgage: A mortgage is a type of a "security instrument," the word mortgage literally means death-pledge. The mortgage is a contract between the mortgagor (borrower) and the mortgagee (lender) that secures a promissory note. The mortgage is actually given by the borrower to the lender; it is a contract that stipulates what is being provided as collateral for the note and the responsibilities of the involved parties. The mortgage describes lender remedies (foreclosure) in the event of borrower default. Currently, the most common conventional mortgage document used in Maine is FNMA Form 3020.

Promissory Note: A promissory note is a financial instrument evidencing the creation of debt. The "maker" of the note is the borrower; the "payee" is the creditor. The maker promises timely repayment to the creditor based on the terms and conditions specified in the note such as the principal amount of the loan, the interest rate, the monthly payment and the term (maturity date).

Repayment Period: The period during which the borrow is obligated to make payments on his or her loan.

Reverse Mortgage: *See Home Equity Conversion Mortgage (HECM).*

Right of Rescission: A consumer right provided by the Truth-in-Lending Act that allows borrowers a three-day cooling off period during which they are able to rescind (cancel) a loan transaction.

Risk-Based Lending: When lenders offer consumers interest rates or other terms based on the predicted risk a consumer will fail to repay their loan.

Trade-In: A used vehicle accepted by a retailer as partial payment for another vehicle.

Wall Street Prime Rate: The base rate on corporate loans posted by at least 75% of the nation's 30 largest banks.

Maine's Financial Literacy Publications

Check out the other Downeaster booklets from the Maine Bureau of Consumer Credit Protection. These guides are free to Maine residents. Out-of-state orders are $6 each, or available at volume discount of $4/copy on orders 50 or more (shipping included). Digital editions are available — free of charge — at www.credit.maine.gov.

Downeaster Veterans' Financial Guide — A valuable one-step resource publicized for Maine vets on the topics of health services, educational benefits, auto buying, personal finance, and establishing and maintaining credit.

Downeaster New Homeowner Anti-Scam Advisor — This guide informs consumers of recently purchased homes about common and emerging scams and con-jobs, that could turn the dream of home (ownership) into a nightmare.

Downeaster Credit Report and Credit Score Guide — Learn basics of credit, gain insight into how credit reporting and scoring work, and discover the impact your credit history has on your ability to borrow, with this publication from the Bureau of Consumer Credit Protection.

Downeaster Auto Buying & Financing Guide — From calculating "how much vehicle" you can afford, to vehicle research, shopping for the best APR and deciding on the best loan term for your needs, this booklet is a comprehensive guide to purchasing and financing a vehicle.

Downeaster Credit Card Guide — Learn how credit cards work, how they differ from debit and charge cards, and how to responsibly use credit cards to your advantage.

To order, call 1-800-332-8529 (in-state) or 1-207-624-8527 (outside of Maine).

Consumer Protection Resources

Organization	Contact
Maine Bureau of Consumer Credit Protection	1-800-332-8529 TTY Maine Relay 711
Maine Bureau of Insurance	1-800-300-5000 TTY Maine Relay 711
Maine Bureau of Financial Institutions	1-800-965-5235 TTY Maine Relay 711
Maine Office of Aging and Disability Services	1-800-262-2232 TTY Maine Relay 711
Maine Office of the Attorney General (Consumer Hotline)	1-800-436-2131 TTY 1-207-626-8865
Maine Office of Professional and Occupational Regulation	1-207-624-8603 TTY Maine Relay 711
Maine Office of Securities	1-877-624-8551 TTY Maine Relay 711
Maine Public Utilities Commission (Consumer Assistance Division)	1-800-452-4699 TTY 1-800-437-1220
Maine Real Estate Commission	1-207-624-8524 TTY Maine Relay 711
Consumer Financial Protection Bureau (CFPB) (Federal)	1-855-411-2372 TTY 1-202-435-9742
National Credit Union Administration (NCUA)	1-800-755-1030
Federal Reserve Consumer Hotline	1-888-851-1920
Federal Trade Commission Consumer Response Center	1-877-382-4357
Federal Trade Commission ID Theft Hotline (after dialing, press “0” to reach a live operator)	1-877-438-4338
Internet Crime Complaint Center (IC3)	www.ic3.gov
U.S. Postal Inspection Office (ask for the Portland, Maine Field Office)	1-877-876-2455

NOTES

This book is not intended to be a complete discussion of all statutes applicable to consumer credit. If you require further information, consider contacting our agency or an attorney for additional help.

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