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Mortgage Brokers: The salesman factor

The right mortgage broker is golden - a pro who can put you in the ideal loan at the best rate. The wrong one can hang you out to dry.

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(Money Magazine) -- In the next five years, 1.4 million Americans will see their mortgage payments more than double. Already, half a million homeowners are 90 days behind on their payments. Foreclosure rates are up 30 percent from 2006.

How did so many end up in trouble? Was it consumer overreaching or a bull market in bad advice? Many consumer advocates and legislators believe that the latter played a big role - and are blaming mortgage brokers, the independent agents who in the past few years have sold nearly 70 percent of the nation's home loans.

"We think brokers bear a lot of the responsibility for placing borrowers into these unaffordable loans," says Allen Fishbein, director of housing and credit policy at the Consumer Federation of America. Critics like Fishbein warn that the system gives brokers powerful incentives to push consumers into toxic loans and little to fear if their customers can't handle them.

Does this mean you should shun mortgage brokers? Not necessarily. A good one can save you time and thousands of dollars over the life of a loan - but it's up to you to understand the loans you're being offered and the fees involved. Here are the key questions.

Do I Even Need a Broker?

If you keep abreast of mortgage products, know exactly what is the best loan for your situation and have days to call banks, get quotes and make comparisons, you probably don't need a broker.

"You should go to a broker if you want help," says Jack Guttentag, founder of the Mortgage Professor website (at mtgprofessor.com) and professor of finance emeritus at the Wharton School. "Otherwise, shop online."

Guttentag's site ranks online lenders, including the virtual outposts of such institutions as Bank of America and Chase. Top picks, based on transparency of loan terms and fees: Amerisave and E-Loan. In late June, for example, E-Loan offered a $200,000, 30-year fixed mortgage at 7.125 percent interest and $912 in closing costs to clients with good credit.

If you're not particularly confident about hunting down a loan, however, there's a strong case for hiring a broker. Brokers tend to deal with many banks, so they can advise you on a wider variety of offerings than a single bank's loan officer can. Plus, brokers have more time to shop than you (it's their job) and have access to rate sheets and wholesale lending rates that banks don't share with consumers.

That doesn't mean you should assume every broker will always steer you to the cheapest possible loan. This brings us to the next question.

Whom Can I Trust?

The ideal mortgage broker is a seasoned professional who comes highly recommended. Unfortunately, the bubble swelled the ranks of mortgage salesmen by 100,000 in nearly a decade, to 334,000, according to Wholesale Access, so "seasoned" is a relative term. What's more, while a broker must be licensed, most states set no minimum qualifications for the salespeople he employs.

Normally, hiring a professional would start with getting recommendations, but that's tricky too. Friends may not know whether a broker got them the best deal, and real estate agents and financial planners may have financial ties to a broker.

So go ahead and get referrals, but don't stop there. Search for local mortgage brokers on NAMB.org, the website of the National Association of Mortgage Brokers. Unlike many of the ubiquitous online mortgage advertisements (think dancing cowboys), which demand information from you and then sell it to brokers and lenders, NAMB's site gives you brokers' names and, in many cases, the rates and fees they're quoting.

Then you can do the pursuing, not the reverse. Call at least three brokers for quotes - all on the same day, since rates change daily.

When you call, ask how much the broker stands to make on your loan. How straightforward the answer is may tell you all you need to know on the trust question.

Most earn their keep in two ways: by collecting part of your closing fees and by pocketing a variable fee from the lender called a yield spread premium - which banks increase to reward brokers for selling, among other things, a higher interest rate.

The problem with the yield spread premium is that it gives brokers an incentive to sell loans at elevated interest rates as well as attach features like prepayment penalties - in other words, to act in the bank's interest, not yours. It's another reason you should shop around even when using a broker.

One way to evade this inherent conflict of interest is to hire a so-called up-front mortgage broker. An up-front broker signs an agreement promising to take the same fee - typically 1 percent to 2 percent of your loan, paid by you, the bank or a combination - regardless of the terms of your mortgage.

Although the preset fee may not always represent a big savings over what a conventionally paid mortgage broker would collect, it does remove hidden incentives. Unfortunately, up-front brokers are still rare (go to upfrontmortgagebrokers.org to find any in your area), but you can always ask any broker to set his fee up front.

Whichever arrangement you and your broker agree to, check the firm's complaint record with your state's banking department (find its Internet address on the Conference of State Bank Supervisors website at csbs.org) as well as the Better Business Bureau's site (go to bbb.org)

Am I Getting a Fair Shake?

Even if you've signed on a pro who comes recommended by people you trust, quotes a low rate and is frank about his compensation, you can't check out of the process. You still need to be ready to stand up for yourself along the way.

Refuse to pay application fees. When interviewing brokers, make it clear that you won't pay application or commitment fees. The only fees you should pay in advance are for appraisal ($350 or so, on average) and a credit report (around $20), says National Association of Mortgage Brokers president-elect Marc Savitt. And Savitt says that locking in your interest rate for less than 60 days should come free as well.

Know what can go wrong. A recent Federal Trade Commission study found that most borrowers don't understand the fees or terms of their loan. Don't be one of them. Ask your broker for the pros and cons of at least three different types of loans, says Steven Krystofiak, president of the Mortgage Broker Association for Responsible Lending.

With any adjustable-rate loan, make sure your broker explains how your rate and payment could change and what your worst-case scenario is. The loan disclosures you get will also document how high your rate can go. Make sure they agree with what your broker told you.

Negotiate fees. Once you've decided on a loan, scrutinize the closing costs. You'll find them on the disclosure document known as the good-faith estimate, which the lender is required to provide within three days of your applying for a loan. The estimate should also include the yield spread premium, commonly listed as YSP or POC ("paid outside of closing").

Pay attention to the total, not the individual charges. Nationwide, the total out-of-pocket closing costs for a $200,000 loan, not including taxes or your prorated portion of bank interest and insurance, average 1.5 percent. If the costs add up to much more than that, ask the broker to cut his fees.

At this stage your only outlay is probably the $20 or so for your credit check and possibly $350 for an appraisal, so you can still credibly threaten to go elsewhere if the fees seem unfair. Once you agree on the costs, ask the broker to guarantee them through closing.

Tolerate no changes. Brokers have no legal obligation to stick to their estimates. But they should do so, or at least notify you of any changes before closing. Request your final papers a day in advance and compare them with the good-faith estimate.

"There should be no surprises when you get to the closing table," says Savitt. Demand that any changes revert to what was contained in the estimate. If the broker won't budge, appeal to the lender.

And remember: When it comes to the home-lending process, there's only one person who's working just for you. That's you.