

PROFITING
FROM THE
BANKING
INDUSTRY'S
BIGGEST
SECRET

A Consumer Guide Presented by: **The Asher Institute** FOR CONSUMERS

A NON-PROFIT CONSUMER ADVOCACY ORGANIZATION

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INTRODUCTION

The **Asher Institute** FOR CONSUMERS WAS formed in 2003 to educate and inform consumers about various consumer issues so they can make smarter decisions regarding finances, banking and mortgages. The Institute has identified a major consumer misnomer that needlessly costs American consumers billions of dollars a year. The misnomer is perpetuated by the banking industry in order to maximize profits and has been very successful due to the misinformed status of the public. This Guide reveals the banking industry's biggest secret and how consumers can take advantage of it.

IMPORTANT INFORMATION FOR CANADIAN CONSUMERS.

The information contained in this report is valid for Canadian Consumers and well as America Consumers.

The mortgages are constructed somewhat differently, but the statistics and other calculations are for all meaningful purposes the same. Making the information in this report accurate and valid.

Canada uses Terms as opposed to fixed rate and Adjustable Rate Mortgages which are available only to USA customers.

In Canada mortgages are usually amortized over 25 years instead of the USA average of 30 years. It is important to note that Canadian Banks and Mortgage Lenders have begun to issue 30 year, 35 year and 40 year mortgages.

It is important to understand that the longer the mortgage amortization, the greater the amount of mortgage interest payable. Canadian banks are offering these longer amortizations under the guise of "affordability". The payments are indeed cheaper per month, but the increase in total interest costs can be staggering. You can expect to increase your total mortgage interest costs by 25% to 40% or more depending on the amortization periods over and above the traditional 25 year canadian average.

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What does the banking industry's biggest secret concern? Mortgages. When it comes to mortgages, most consumers are knowledgeable and able to choose between various loan products and select the right home loan for their risk tolerance. The most highly promoted loan type of all, the 30-year fixed-rate mortgage, is the one most often selected. Our research revealed some shocking truths about the 30-year fixed that equally stunned both consumers and mortgage industry experts alike.

Consumers choose a 30-year fixed based on two things and only two things- a low fixed rate and a low fixed payment. But the Institute found that only ONE of those two things is actually true. The other one is false. Which one is false? The part about the interest rate being fixed. Contrary to public opinion, the interest rate on a 30-year fixed-rate mortgage is NOT fixed. That's right, NOT fixed. You will learn that a 30-year fixed-rate mortgage is actually an **ADJUSTABLE RATE MORTGAGE** and the rate consumers are really paying on them is much, much higher than they could ever imagine, completely blocking their paths to financial freedom.

Because common wisdom says that a 30-year fixed-rate mortgage must actually have a fixed rate, it's an easy sell for the lenders, who profit substantially from the misnomer. The Institute finds nothing wrong with corporations profiting as that is their sole purpose. However, since this particular profit game is the result of a misinformed public, we find the solution is to inform consumers exactly how it all works.

In order to understand the misnomer, you'll have to learn a lot more about mortgages and this Guide will serve as the medium. We'll start by just looking at the obvious, how a low-rate 30-year fixed works. On the next page, you'll see an Amortization Schedule for a low-rate 30-year fixed. This chart shows how much of each year's payment goes to Principal(to the loan balance, to the consumer) and how much goes to Interest(to the lender). For examples throughout this Guide, we'll use an average American conforming loan, a \$150,000 30-year loan at a "fixed" interest rate of just 6.0%. The Amortization Schedule shows how the loan *really* works, and keep in mind that at the same rate, it works exactly the same as any other loan amount. Whether a 30-year loan around 6.0% has a balance of \$50,000 or \$500,000, the proportion of Principal to Interest is the same.

\$150,000 30-YEAR FIXED-RATE MORTGAGE AT 6.0%

	<u>“THE LENDER”</u>	<u>“THE CONSUMER”</u>	<u>PAYMENT = \$899.33</u>
Year	Interest	Principal	Balance
1	\$8,949.89	\$1,842.02	\$148,157.98
2	\$8,836.28	\$1,955.63	\$146,202.35
3	\$8,715.66	\$2,076.25	\$144,126.11
4	\$8,587.60	\$2,204.31	\$141,921.80
5	\$8,451.65	\$2,340.26	\$139,581.54
6	\$8,307.30	\$2,484.61	\$137,096.93
7	\$8,154.06	\$2,637.85	\$134,459.08
8	\$7,991.36	\$2,800.55	\$131,658.53
9	\$7,818.63	\$2,973.28	\$128,685.25
10	\$7,635.24	\$3,156.66	\$125,528.59
11	\$7,440.55	\$3,351.36	\$122,177.23
12	\$7,233.84	\$3,558.07	\$118,619.16
13	\$7,014.39	\$3,777.52	\$114,841.64
14	\$6,781.40	\$4,010.51	\$110,831.13
15	\$6,534.04	\$4,257.87	\$106,573.27
16	\$6,271.43	\$4,520.48	\$102,052.78
17	\$5,992.61	\$4,799.30	\$97,253.49
18	\$5,696.60	\$5,095.31	\$92,158.18
19	\$5,382.33	\$5,409.57	\$86,748.60
20	\$5,048.68	\$5,743.23	\$81,005.38
21	\$4,694.45	\$6,097.45	\$74,907.92
22	\$4,318.38	\$6,473.53	\$68,434.39
23	\$3,919.10	\$6,872.81	\$61,561.59
24	\$3,495.20	\$7,296.71	\$54,264.88
25	\$3,045.16	\$7,746.75	\$46,518.13
26	\$2,567.36	\$8,224.55	\$38,293.58
27	\$2,060.08	\$8,731.83	\$29,561.75
28	\$1,521.52	\$9,270.39	\$20,291.37
29	\$949.75	\$9,842.16	\$10,449.21
30	\$342.70	\$10,449.21	\$0.00

Each year, the consumer pays \$10,792 but a different portion of that total gets credited to Principal and to Interest. In the first year, \$8950 of the payments go straight to the lender and the remaining \$1842 gets credited back to the consumer. Here are some other facts gleaned from this schedule:

- It takes 19 years before just *half* the monthly payment goes to Principal, the consumer (\$5482 to Principal, \$5309 to Interest).
- It takes 24 years before 2/3 of the monthly payment goes to Principal.
- After 7 years, the consumer has paid \$75,600 but only \$15,541 goes to Principal.
- After 10 years, over 84% of the starting balance is still owed.
- After 15 years, over 71% of the starting balance is still owed. At that point, the consumer has paid \$161,000 in payments, more than the original starting balance.
- After 21 years, half of the starting balance is still owed. At that point, the consumer will have paid \$226,800 with only \$75,000 of it going to Principal.

The numbers are heavily skewed in favor of the lender because they are designed to be. It's due to something many consumers are familiar with, front-end loaded interest. Even though the monthly payment is fixed, each payment has a different contribution to Principal than Interest, and the contribution to Interest in the first years is much greater than in the last years. The result of this system is that the lender collects their interest first, up front.

The Institute found that most consumers know that the interest on mortgage loans is front-end loaded, purposely stacked against them. But we also found that those same consumers, no matter how educated, as well as mortgage industry experts, do not realize that the front-end loaded interest completely throws off the fixed interest rate schedule. Look back at Year 1. The consumer pays \$10,792 but only \$1842 of it gets credited back to Principal. What if he sold his house after that first year? Would it seem like he paid a 6.0% rate? Look even after 10 years. The consumer pays the lender almost \$108,000 but less than \$25,000 of it goes back to Principal. That's not a 6.0% rate. The same holds true for even longer periods of time like 20 and 25 years. So if a 30-year fixed is kept for even 1 month less than 30 years, the rate consumers really wind up paying on it is higher. How much higher? The Effective Rate Formula reveals what the actual, real interest rate would be if a front-end loaded loan was kept for less than the entire 30-year term.

EFFECTIVE RATE

The Effective Rate calculation is a measure of the actual interest rate consumers pay on their home loans by factoring in the front-end loaded interest. The formula asks, “What rate would I really pay if I only held a front-end loaded loan for X number of years?”

Using a financial calculator:

PV = equity built in a given time period.
N = number of years being analyzed
PMT = monthly payment(as a negative sum)

CPT, then I/Y(Compute, then Interest/Year) = Actual Interest Rate

When we applied this formula to our sample 6.0% 30-year loan, the results were as follows:

If our sample 6.0% loan is kept for 25 years, the consumer would wind up paying almost \$270k over 25 years for \$104k in loan equity. Entered into our formula, the actual rate is **9.43%**. That’s right, **9.43%, not 6.0%!** And that’s based upon giving up the loan only 5 years early.

Now how much would the real rate be if that loan was kept for 20 years? The answer is **14.82%**. What about for 15-years? The answer keeps rising. It’s a **24.16%** interest rate. Paying \$161,879 and with less than \$44,000 of it going back to Principal shouldn’t seem like a 6.0% rate because it *isn’t*.

And it only gets worse. Holding on to that low 6.0% fixed-rate 30-year loan for 10 years results in paying an actual **43.48%** interest rate. Keeping it for 7 years results in paying a staggering **68%** interest rate to the lender. Keeping it for only 5 years results in the equivalent of a **102%** rate. Holding it for 3 years yields an actual **182%** rate and 1 year a **580%** rate!

We informally polled hundreds of consumers as well as mortgage industry experts, some of whom have over 25 years of experience in the business, with the following question: “If you held a 6.0% 30-year fixed-rate loan for 7 years, considering that the interest is front-end loaded and you’re not waiting 30 years for it to all even out, what rate do you think you’d really wind up paying?”

The responses to this question and reaction to the correct answer spurred the development of this Guide. Every time, the consumer or expert guessed between 8% and 12% with an occasional highest answer of “triple,” which would represent 18%.

There was never a guess greater than 18% and yet the reality is that the Effective Rate is actually 68%, almost 400% greater than any guess. The guesses were logical, yet so far off that it became instantly clear that a gross and major misconception on the part of the general public existed.

It was also clear that these numbers had never been disclosed to consumers. Not one respondent had ever heard of an “Effective Rate” calculation or a similar formula. What impacted the Institute the most, however, was the reaction of the respondents after we revealed the actual answer of 68%. One respondent after another was stunned and silenced. It seemed consumers were well aware that mortgage interest is front-end loaded but no one seemed to have any idea just *how* front-end loaded it really is.

What the Effective Rate demonstrates is that the **only** way to wind up paying the low advertised Note Rate is to keep the loan for all 30 years. Due to the interest being front-end loaded, the rate becomes ADJUSTABLE based upon how long the loan is kept. On a 6.0% 30-year fixed, the low “fixed” 6.0% Note Rate is the absolute MINIMUM rate a consumer will pay. Even though the monthly payment is fixed, a consumer may wind up paying as much as a 580% interest rate. So a 30-year fixed-rate mortgage is actually an Adjustable Rate Mortgage.

YEAR 5

The Effective Rate also shows that the entire concept of the 30-year loan is based upon the single principle of keeping it for the entire term. The banks have been relying upon consumers to concentrate on the fact that it all evens out 30 years later. But how many consumers keep the same mortgage for 30 years? The fact is:

NATIONALLY, HOMEOWNER’S KEEP THEIR MORTGAGES FOR:

5 YEARS ON AVERAGE

Whether they refinance, move for a new job across town or across the country, whether they’re about to have kids or the kids are about to move onto college, Americans keep their home loans for an average of just 5 years. They keep their *homes* for longer than 5 years, but their mortgages for only 5. Previously, the long-standing national average was 7 years but with the golden era of refinancing of the early 2000’s, the average has decreased to just 5 years.

By combining the 5-year statistic with the U.S. Department of H.U.D.'s 2003 data which shows the national average mortgage interest rate is 6.16%, the Effective Rate Formula shows us that **homeowners, on average, are paying a 107% interest rate on their mortgages**, what many consider to be their biggest and best investments - most without ever realizing it. And lenders are quietly earning an average of 107% in interest on billions of dollars of home loans, significantly contributing to record profits quarter after quarter.

The Institute believes this fact can't be understated or underestimated based upon the rates consumers pay on different trade-lines. On cars, they pay between 0 and 15%, on credit cards they pay between 0 and 30% and yet on their "low 6.0% fixed-rate" mortgage, the largest debt of all, they pay an average rate of 107%. Their credit card balances may be only 15k and the auto loan may be 20k but that super high-rate mortgage has a balance of 100k or 200k or more. Consumers are paying the highest rate on their largest loan.

Now think about this scenario. An average American who earns \$50,000/year, has a wife and 2 children, a modest retirement account and a 30-year mortgage. We give him a credit card that has a \$150,000 balance with an APR of 107% and tell him that he's now responsible for it – the debt it his. What would happen to his family's life and future outlook if he had *that* credit card? What would it do to them financially?

The answer is that it would probably devastate his family and severely limit any opportunity they had to gain or build wealth. The numbers prove that the 30-year fixed-rate mortgage is equivalent to a giant credit card with an astronomical APR. Millions upon millions of American consumers have this credit card, this massive liability, which serves as nothing but a giant mountain standing in the way of their financial hopes and dreams. The mountain's bigger than Mount Everest yet remains invisible due to the deceptive nature of the game. And no matter how much more consumers earn at work and no matter how much their other investments return, it winds up being meaningless in the long run because that home loan, that 107% APR'd "credit card" is sucking all the wealth-building power out of them.

If you have ever re-financed a mortgage, you have been a victim of this hidden scheme. You should never re-finance without a concrete plan in place to decrease the amount of excessive interest you will be legally obligated to pay.

At F.E.A.T. Inc, our governmented copyright plan is specifically designed to take the wind out of the banks and moneylenders "wind-fall" profits they would earn at your expense. You can actually "Pay less and Pocket the rest". There is no out-of-pocket cash required ... period. If you qualify, you can have it and if you do not qualify, you cannot have it ... it's as simple as that.