



Choose a Mortgage that's Comfortable to Live With

A guide to selecting the best mortgage program for you

You've found your house, you've made an offer, but now you've got to decide how to pay for it. With all the options available today, trying to decide on a mortgage can leave you a bit baffled if you're uninformed. You'll get the best deal if you know your options—here's a guide to the basic types of mortgages available.

Fixed-Rate Mortgages

Looking for stability? Found your dream home and plan to stay there for the next 15 years? Investigate a fixed-rate mortgage. Whether you go with a 15, 30 or the new 40 and 50-year fixed-rates, these types of mortgages are like getting an insurance policy on your interest rate—the rate stays the same, so your monthly payment also stays constant. The upside and downside of this most common type of mortgage? While the rates never go up, they also never go down, unless you refinance.

Adjustable Rate Mortgages

Adjustable rate mortgages, or ARMs, became popular in the mid 1980's because they start with an attractive, lower fixed-rate, and after an initial period, they adjust according to a specified index. Over the last few years, they became less popular because fixed rate loans were available with low interest rates. They are becoming more popular again with the increase in fixed interest rates. They may look confusing, with the 3/1, 5/1, 7/1, 10/1 and a handful of other options, but they can be easily understood. The first number indicates how many years your interest rate is fixed; the second number indicates how often the rate adjusts after that initial period is over. For example, in a 5/1 ARM, your interest rate stays the same for the first five years, and then adjusts every year after that, up to a cap that you and your lender agree on.

The downfall of these low-rate wonders? After your initial fixed-rate period is over, if interest rates rise, so does your monthly payment. If you can live with that or if you expect to move or refinance in the next few years, then an ARM can save you money over the short-term. Historically, people who have used ARMs have spent less on their mortgage payments than those who

borrowed at fixed rates (except for the past five years) over the longer terms.

Interest-Only Mortgages

Another increasingly popular mortgage option is the interest-only mortgage. This type of mortgage is best for people whose income comes from infrequent commissions or bonuses, or for those who expect to earn a lot of money over the next few years. With interest-only loans, you pay only the interest on your mortgage for a fixed period of time (10 years—usually 100% tax deductible on a primary and secondary residence—on a 30-year fixed rate mortgage). At the end of the interest-only period, you start paying off principal and interest payments and do so until the mortgage is satisfied.

Balloon Mortgages

These mortgages are similar to an ARM, in that you get a low initial interest rate, but after a set number of years—usually 5 or 7—the mortgage ends and you have to either pay off the remainder (with a “balloon” payment, hence the name) or reset the mortgage at current interest rates. Payments are amortized over a set period (often 30 years) at an interest rate that's typically lower than a fixed-rate mortgage, so if you plan to move before the balloon maturity date, you can usually save money. But if you plan on staying put, and interest rates rise dramatically over the next few years, your payments after a reset will probably increase substantially.

Low-Doc/No-Doc Mortgages

If you are self-employed or have bruised credit, a low-doc, no-doc or no-ratio mortgage may be a good option to get you started. When

considering you for one of these mortgages, lenders usually analyze your credit, income and/or assets. For slightly higher interest rates—depending on what you provided and the lender's estimated risk—you may get mortgage approval without having to provide a lengthy financial history.

The Resources

U.S. Department of Housing and Urban Development—all the info in one place.

> www.hud.gov

FHA Loans are home mortgages that make it easier for the first-time buyer or anyone who does not currently have an FHA loan.

> www.fha.com

VA Loans for the military get you in a home with no down payment.

> www.homeloans.va.gov



Sorting Out the Acronyms: A Guide to General Mortgage Terms

With all the complicated terminology, acronyms and industry lingo used in the mortgage industry, even the expert linguist can sometimes end up baffled. Collected below are a few of the more common terms used in lending today. If you feel like you and your lender are speaking different languages, reading the definitions listed below can help you get on the same page. In addition, look to the bottom of the page for a visual map of how the lending process works. Most importantly, when discussing mortgages, make sure you talk to a professional that you can trust.

APR (Annual Percentage Rate)

APR is a number that expresses the effective interest rate that will be paid on a loan, taking into account one-time fees and standardizing the way the rate is expressed. The APR is the total cost of credit to the consumer, expressed as an annual percentage of the amount of credit granted. In the U.S., lenders are required to disclose the APR before the loan (or credit application) is finalized.*

Conventional Loan

Any non-government loan program is a conventional loan, most of which are provided by banks, savings and loans, mortgage bankers and mortgage brokers (basically, the private sector).

FHA (Federal Housing Administration)

An agency of the Department of Housing and Urban Development. The FHA guarantees certain loan programs for all Americans; insures loans that are made by approved lenders to qualified borrowers; and allows low income and/or low down payment loan borrowers the opportunity to purchase a home that they might not have been eligible for under conventional loan programs. This is a good program for first-time buyers and those with bruised credit, no credit or a low credit score (under 620).

GFE (Good Faith Estimate)

Within 72 hours of originating a residential loan application, the federal government requires that a good faith estimate is presented to the borrower, outlining the costs and charges a borrower is likely to incur in connection with the loan closing. However, the GFE is not a guarantee that the applicant will be approved for the loan or that the final amount will be the same figure; the amount (interest rate, terms, conditions) may change pending final loan approval and down payment terms.

MIP (Mortgage Insurance Premium)

The amount that the FHA charges up front when they insure a loan under one of their programs. The FHA pays the money into a fund where the money is held until it is needed in the event of a default by a buyer.

PMI (Private Mortgage Insurance)

If a mortgage loan exceeds 80% of the sales price of a home, lenders usually require insurance coverage that will protect them in the event that a buyer defaults on their loan. The cost of PMI is typically charged to the borrower when the loan-to-value ratio is greater than 80%.

Points

An upfront cash payment required by the lender as part of the charge for a loan, expressed as a percent of the loan amount; e.g. "2 points" means a charge equal to 2% of the loan balance.**

Pre-approved

A general term that means that a borrower has completed a loan application and provided their credit, income, savings and assets, plus all other required information, and an underwriter has then reviewed and approved the specific mortgage type and amount required.

Prequalification

A preliminary step in the loan application process. The prequalification is a lender's written opinion of the ability of a borrower to qualify for a particular loan amount. The amount prequalified by the lender is determined based on inquiries into the borrower's debt, income and savings, and may or may not require a credit check or any other proof.

Ratios

Ratios are used in the lending industry to determine the probability of a borrower being able to repay a loan—usually this ratio compares the borrower's fixed monthly expenses to his gross monthly income. Certain lenders have different ratio requirements; for example, the FHA requires that a monthly mortgage payment is no more than 29% of monthly gross income (before taxes) and that the total of mortgage payment and non-housing debts is less than 41% of income.

In lending, these two figures are represented as 29/41: **29** is the Front-End (Housing) Ratio monthly mortgage payment (principal, interest, taxes and homeowners insurance, mortgage insurance and homeowners association expenses) divided by gross monthly income before taxes; **41** is the Back-End Ratio (monthly housing expenses plus non-housing mortgage insurance and homeowners association expenses, such as car loans and credit card debt, divided by gross monthly income before taxes).

TIL (Truth in Lending Statement)

Federal law that requires that lenders fully disclose, in writing within 72 hours of origination, the monthly payments and amount financed, as well as additional terms and conditions associated with the loan.

VA (Veterans Administration)

The department of the federal government that handles all programs associated with veterans of the U.S. military. In the mortgage industry, the agency guarantees loans that are made to veterans (similar to mortgage insurance), thereby encouraging lenders to offer mortgages to veterans.

* definition from Wikipedia encyclopedia

** definition from www.mtgprofessor.com/glossary.htm

The Loan Process

