

Selecting Your Mortgage



A mortgage represents a loan or lien on a property/house that has to be paid over a specified period of time. Think of it as your personal guarantee that you'll repay the money you've borrowed to buy your home. Mortgages come in many different shapes and sizes, each with its own advantages and disadvantages. Make sure you select the mortgage that is right for you, your future plans, and your financial picture.

Selecting your mortgage is just as important as selecting your home. There are many things to consider, and your decision will make a big difference in your monthly payments and your overall cost.

Learn how to evaluate your mortgage loan options

The best way to evaluate different mortgages is to compare them in writing, and I recommend keep track of the information you obtain from different lenders. Be sure to ask for all their costs, including loan and origination fees and discount and origination points. Ask what the Annual Percentage Rate (APR) of the loan is. The APR factors in both the interest rate and fees.

Be sure to ask for a "good-faith estimate" (GFE) in writing from each lender. A good-faith estimate will outline all the costs and help you compare lenders and mortgage products. A GFE is a best approximation of your final costs, not a guarantee. Still, you should not expect a large difference between the GFE and the final statement at your closing. You can see a sample GFE at the US Department of Housing and Urban Development web site.

Understand mortgage rates

It is important to shop around to find the mortgage and mortgage rate that is right for you. You'll have to choose between a fixed-rate, adjustable-rate or balloon/reset mortgage and you will also have to choose your loan terms. Keep in mind that the lowest mortgage rate or longest loan term may not always be the best choice. You should also consider the overall cost of the loan, including fees (application, escrow, and appraisal fees, for example) and points.

Mortgage rates change frequently. With many lenders, you can "lock in" the rate, which allows you to complete the mortgage process knowing the exact interest rate you'll get for the life of the loan if the loan is a fixed rate or for the initial period if the loan is an ARM or a balloon/reset mortgage. If you believe rates will increase while your mortgage is being processed, you might lock in the current interest rate through your closing date. A typical lock-in lasts 30-60 days.

If you choose not to lock in your rate, you can "float" the rate. This means that you can follow market rate trends and choose to lock in when the rates are more favorable. However, you will have to lock in

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your rate at the end of the float period usually 72 hours before closing.

Even a fraction of a percent can make a big difference in your mortgage payment, so you'll want to shop around and compare rates. The Primary Mortgage Market Survey published weekly by Freddie Mac is one of the most reliable sources of mortgage rate trends. Ask your lender to share it with you.

Understand the differences between fixed-rate and adjustable-rate mortgages

Interest rates are one of the single biggest factors when choosing a mortgage. Generally, the lower the interest rate is, the better the mortgage is, but it really depends on the type of mortgage you choose and such factors as the loan to value ratio, and the fees and points charged by the lender. There are two basic types of mortgages: those with fixed rates and those with adjustable rates. A variation on both is a balloon/reset mortgage, which offers some features of each.

Fixed-Rate Mortgages - The interest rate for a fixed-rate mortgage never changes for the life of the loan, so your monthly principal and interest payment always stay the same.

Adjustable-Rate Mortgages (ARMs) - ARMs usually start with a low interest rate. After the initial period when the interest rate doesn't change, the interest rate will often adjust each year. This means your principal and interest rate payment could increase or decrease over time.

If you plan to keep your home for five or more years, a fixed-rate mortgage will likely be the best option for you.

If you expect to move within the next four years, or you're confident your income will increase steadily over time and you want to start with a lower monthly payment, an adjustable-rate mortgage may make sense. ARMs usually start with lower interest rates - and that means lower monthly payments at first. But keep in mind that ARM interest rates can go up over time - and so can your payments.

Know how 15-year and 30-year mortgages change your monthly payments

When you're looking for a mortgage, you need to decide which loan term you want and choose the type of interest rate.

The loan term is the length of time you have to pay back the loan. The longer the term, the lower the monthly payment. The shorter the term is, the higher the monthly mortgage payment will be.

Most home mortgage lenders offer two basic terms: 15 and 30 years, and some may offer 20-year fixed rate mortgages:

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15-Year Term

This term has higher monthly payments because the loan is shorter. The interest rate is usually lower and you can build equity faster.

20-Year Term

This fixed-rate mortgage builds equity more quickly than with a traditional 30-year mortgage as well as saves you interest over the life of your loan.

30-Year Term

Interest rates may be somewhat higher for this term and you pay more interest over time.

If you can make higher payments and want to build equity quickly, a 15-year term may work for you. If you want to qualify for a larger loan amount, a 30-year term may be a good choice - especially if you don't plan to move and the interest rates are reasonable when you sign the loan. This is generally the easiest loan term to qualify for. You can always make larger monthly payments and ask your lender to re-amortize your loan to pay your loan off faster.

Understand down payments and closing costs

When you buy a home, there are several up-front costs you should be aware of, particularly down payments and closing costs.

Down Payments

A down payment is usually between 3% and 20% of the total cost of the home, but may be as little as no money down. The amount of the down payment depends on your credit history, income, the cost of the home, and the type of mortgage you choose. While most people make a down payment from their own funds, other sources of down payment are sometimes available including federal, state and local governments, non-profit organizations and, of course, relatives. (For example, the City of College Park, MD offers a grant of \$5,000 to anyone who buys a rental property and converts it to an owner-occupied property; the amount increases to \$7,500 for city employees and police officers.)

If your down payment is less than 20%, private mortgage insurance (PMI) may be required. This is insurance you pay to protect the bank if you don't repay your loan in full. PMI is added to your closing and monthly mortgage costs. When you apply for a home loan, many mortgages require you to also have at least two month's worth of mortgage payments saved, called reserves. However, there are mortgages that do not require reserves. And there are loan programs that avoid the PMI through a combination of a first trust mortgage and a second trust mortgage. Be sure to ask your lender about this option.

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Most lenders want to know the source of your down payment and have restrictions about how much can come from gifts from your relatives, depending upon the loan program. In most cases, these gifts will need to be documented using a specific form provided by the lender.

Closing Costs

Closing, or settlement, costs are fees you pay when you actually get your loan from your financial institution. These include points, taxes, title insurance, financing costs, items that must be prepaid or escrowed, and other settlement costs.

Closing costs generally range between 2-7% of the loan value. You'll receive an estimate from your lender after you apply for a mortgage (Good Faith Estimate). You will pay these costs at the time you close on your loan.

Source: FreddieMac.com and Margaret Woda

