realtor.com®

MORTGAGE 101

Six mortgage must - knows before you head out to find your own home.

MORTGAGE BASICS

What is a mortgage?

A mortgage is a loan that is used to finance the purchase of your home. It consists of 5 parts: *collateral, principal, interest, taxes, and insurance.*

When you agree to a mortgage, you enter into a legal contract promising to repay the loan, plus interest and other costs. Your home is used as collateral for the loan. If you fail to repay the loan, the lender has the right to take back the property and sell it through a process called *foreclosure.*

The *principal* is the amount of money that is borrowed to buy a home. You can put down a percentage of the home's purchase price, called a *down payment*, to lower your loan's principal amount. Lenders offer a wide range of down payment options, so it's best to ask which one makes the most sense for you.

Interest is what the lender charges to use the money you borrowed. This amount is usually expressed as a percentage called the interest rate. *Principal and interest make up the bulk of your monthly payments* in a process called *amortization*. Amortization reduces your debt over a fixed period of time. Your mortgage payment will also likely include *taxes* that are collected by the local community based on a percentage of the value of your home. These taxes usually go toward things like schools, roads, and public services.

Lenders will also require you to buy *insurance* to cover your home against losses from fire, theft, bad weather, and other causes. Additional types of insurance may be required depending on the location of your home and the type of loan you choose. They include flood insurance, private mortgage insurance (PMI), and mortgage insurance for loans backed by the Federal Housing Administration.

Finally, when choosing a mortgage, you may have the option to use positive or negative *mortgage points*, which can alter your interest rate and closing costs. *Positive mortgage points* are paid as an upfront fee at closing and can help lower your interest rate. *Applying negative points to a mortgage increases your interest rate but may reduce closing costs.*

Now that you've got the fundamentals down, keep in mind that lenders offer a wide range of loan products, so make sure to ask which product can work best for you.

MORTGAGE RATE REVIEW

How does it work?

Mortgage rates *matter*. Just one-eighth of a point in interest percentage could end up costing you thousands of dollars over time. So, let's look at how mortgage rates work and move.

Conventional mortgage rates are tied to U.S. Treasury bonds, mainly the 10-year bond. Interest rate changes on conventional loans are a result of current yields for 10-year bonds.

It works like this:

If bond yields increase, mortgage rates increase.
If bond yields decrease, mortgage rates decrease.

Adjustable-rate mortgages (ARMs) are different. ARMs are short-term interest loans and are *mostly affected by the federal funds rate.*

Fluctuations in the economy also affect interest rates. When the stock market is doing poorly and investors are selling, you can expect interest rates to lower. This happens when fearful investors transfer their money into the safety of U.S. Treasuries. *With more money pumped into the bond market, the higher the demand and the lower their yield becomes—and the result is that mortgage rates fall.*

Stimulus—the Fed buying up bonds—can also cause rates to drop. Stimulus may occur over several years with billions of dollars, but it has to stop at some point. When it stops, interest rates generally rise.

When trying to pin down low interest rates, world and national events and things like inflation all play a part. As a general rule, if the economy is running strong, interest rates will usually rise.

Finally, remember this: It's impossible to predict exactly where the economy will go, so don't get too caught up in trying to nail a perfect rate—it's more realistic to simply aim for a good one.

COVERING CREDIT

It matters. Learn ways to improve yours.

When you're serious about buying a home—and looking to qualify for a mortgage—credit matters. Lenders take a long look at your credit scores, and those numbers determine the options available to you.

If your credit score is below 680, or you have credit blemishes or little equity, it can drive up the cost of a mortgage.

Boosting your credit score before you apply for a loan can help you get a better rate, and we'll cover ways to pull that off. Mortgage lenders look for good credit scores and the absence of bad credit marks, such as:

- Defaults in payment
- Lawsuits
- Liens
- Bankruptcies
- Repossession
- Foreclosure

Payment history is the greatest factor in your FICO credit score, accounting for 35%. The other factors are amounts owed (30%), length of credit (15%), new credit (10%), and types of credit (10%).

Maintaining good credit isn't always easy, but there are *steps you can take to keep a healthy score:*

- Offer a higher down payment so you borrow less money.
- Do not apply for any new loans or lines of credit during the home-buying process.
- Lower your debt-to-income ratio by paying off as much debt as possible before applying for a mortgage.
- Make all payments on time.

Sometimes credit reports may misreport negative events—so monitor your credit report every few months. Dispute any claims that don't look right.

To learn your ability to qualify for a mortgage, meet with a lender to review your financial circumstances. There is no charge to consult a lender, so even if you aren't ready to get loan approval, you may still benefit from a lender's advice on how to prepare for a loan application.

realtor.com®

DOWN PAYMENTS

What can you really afford? Learn about programs that can help.

For many home buyers, the thought of coming up with a large sum of money for a down payment is daunting. Fortunately, today most lenders offer a wide range of down payment choices that include options for 5, 10, 15, or 20 percent down. And for many first-time buyers, a government-backed FHA loan can be obtained for as little as 3.5 percent down. If you are a military member or veteran, there are even more options available to you. Check with your REALTOR® for more details.

When it comes to procuring the funds for a down payment, there are a few options.

Many buyers tap their savings to procure the funds for a down payment, and often they postpone large outlays and trips in order to save money. Some types of loans allow “gift” funds to be used for a down payment—money that is given by a family member. In order for the gift funds to be used, the family member must have no financial interest in the property, and the funds must be a true gift. Banks won’t allow a “gift” payment if it’s actually a loan that has to be repaid.

Finally, many local and state government programs offer down payment assistance for borrowers in need, so check with your lender or state housing commission for more information. If you choose a loan with less than a 20 percent down payment amount, your lender may require you to pay private mortgage insurance, or PMI. The PMI is usually tacked on to your monthly payment until the loan balance reaches 80 percent of the original amount.

However, there are various loan options that allow you to put down less than 20 percent without the added PMI cost. Check with your lender to see if it offers a low-down-payment, no-PMI product if a 20 percent down payment seems too challenging.

realtor.com®

LOOKING AT HOME LOANS

Compare different options to see what's right for you.

There are a lot of mortgage products out there. To help make sense of it all, let's take a look at some of the most common types of home loans.

Conforming vs. Nonconforming

Conforming mortgages "conform" to rules set by Fannie Mae and Freddie Mac, which often buy mortgages from lenders as investments. Conforming loans are attractive to borrowers because they usually offer lower interest rates.

Nonconforming loans do not follow these guidelines. This means l*enders must find other investors with a higher tolerance for risk*. It's harder to sell these loans, so lenders generally offset their own risk by charging more for them. They also *typically have higher interest rates*, and may carry additional upfront fees and insurance requirements.

FHA Loan

The Federal Housing Administration, or FHA, was created in 1934 to help more Americans secure loans to purchase their own homes. The FHA does not directly lend money to home buyers. *It insures loans made by traditional lenders, such as banks*. If a home buyer defaults on an FHA-insured loan, the FHA covers the lender for the loss. *FHA loans are a great option for buyers who do not qualify for a conventional mortgage.*

Some of the benefits of FHA loans include:

- Credit score requirements that are lower than those of a conventional loan
- A 3.5 percent down payment to qualify
- Greater flexibility for home buyers with recent bankruptcies
- No pre-payment penalty
- FHA loans are assumable

However, with FHA loans, you must pay monthly mortgage insurance, as well as an upfront mortgage insurance premium.

Fixed-Rate vs. Adjustable-Rate

One of the most important decisions you'll make is choosing between a fixed-rate or adjustable-rate loan.

Fixed-rate mortgages, or FRMs, have the *same interest rate for the life of the loan.* Your mortgage is split into equal monthly payments for the duration—a process known as *amortization.*

A 30-year loan is the most common fixed-rate mortgage, but it can also be shorter—such as a 15-year loan.

Some of the benefits of an FRM include:

- Equal monthly payments for the life of the loan
- A fixed interest rate for the life of the loan
- Long-term savings: The longer you hold your mortgage, the more sense it makes to lock in a fixed rate—assuming that rates are low.

Adjustable-rate mortgages, or ARMs, have interest rates that can change throughout the life of the loan.

Some of the benefits of an ARM include:

- *Low initial payments:* Most ARMs have an initial "fixed" period (usually one to five years) when their interest rates are significantly lower than 15- or 30-year fixed-rate loans. During this period, your monthly payments will be relatively low.
- *Possible rate drop:* If you have an ARM and interest rates go down, your monthly payment can drop as well.
- *Short-term gains:* If you plan to sell your home within a few years, the low initial rate offered by an ARM can make it a good option. You'll sell before your ARM readjusts to a higher rate—and potentially save thousands of dollars.

It's good to remember that each home buyer is unique and needs a loan option that fits his or her needs. So be sure to review your options thoroughly with a lending professional.

realtor.com

THE MORTGAGE PROCESS

Learn about the details, like documentation you'll need, average timelines, and fees.

As you prepare to qualify for a mortgage, it helps to know what to expect. Understanding what documentation you'll need, timing involved, potential fees, and how to find the right lender can make or break your experience.

The steps to homeownership:

- Get your finances in order
- Crunch your cash numbers
- Check your credit score (and repair it if needed)
- Know your purchasing power with a pre-approval
- Search for homes in your budget
- Understand your monthly mortgage payment
- Learn about loan options
- Make a fair offer
- Secure a home loan

As you search for the right loan and the right lender, be sure to check references and find someone to function as a consultant on the best loan to meet your needs. Lenders normally want to see evidence of two full years of employment as proof of your financial stability. Be able to explain any gaps in employment, such as maternity leaves or taking extended time off. You'll need recent pay stubs, bank statements, tax returns, and rental or mortgage payment history. A loan officer will submit your application through an automated underwriting system—and will receive an approval or an ineligibility ruling right away.

Lenders should be able to estimate their costs, which can vary widely—not just by company policy, but also regionally. While they can't predict every transaction cost—like appraisal fees or what a lawyer might charge to represent you—some costs are fixed and should be disclosed upfront.

The amount of time it takes for a mortgage to be approved varies widely. It depends on your lender, loan type, and financial situation, as well as how quickly you provide all the paperwork your lender needs. Mortgage approval could take from a few days to several weeks or months.

Between signing the contract and the settlement date, keep your mortgage secure by

- Responding to all lender requests in a timely fashion.
- Keeping track of all deposits and withdrawals and avoiding major financial moves.
- Maintaining your credit profile (don't apply for new credit or close any credit accounts).
- Keeping in touch with your real estate agent, title company, and lender—to see if everything is on track.

© 2017 Move Sales, Inc. All rights reserved. 16935CA