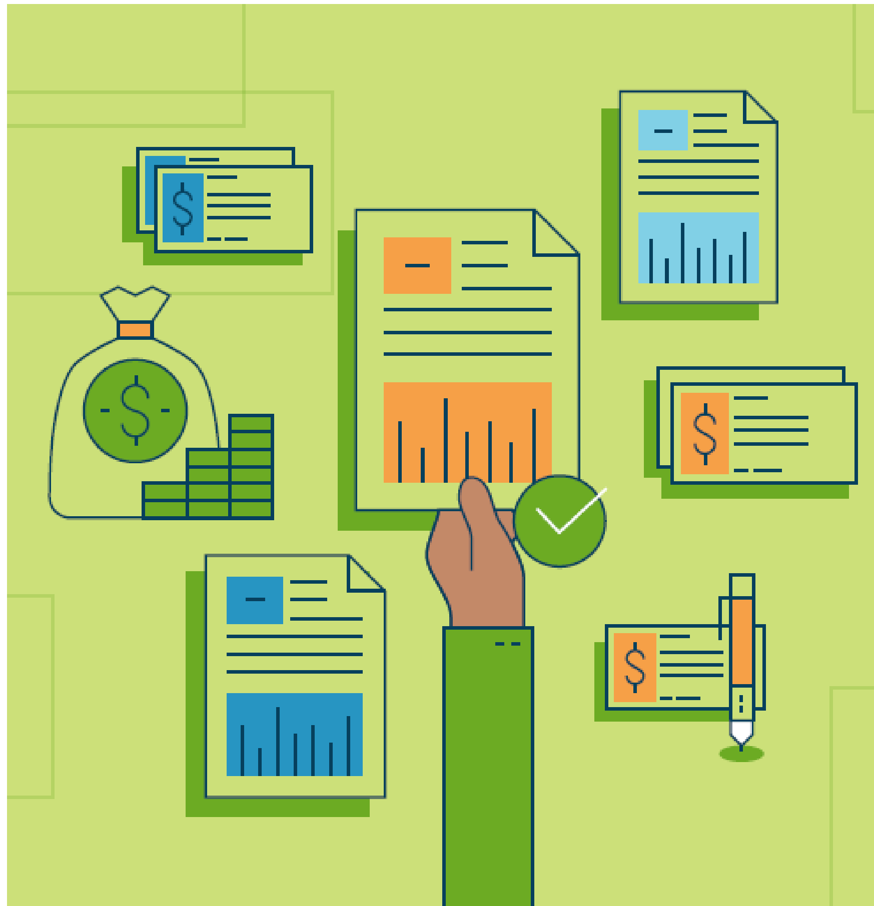
houselogic | Made Possible by REALTORS®

Guide to Home Mortgage Financing



Excerpted from

The Everything Guide to Buying Your First Home

Warren Reynolds, Esq.

Berkshire Hathaway HomeServices
Commonwealth Real Estate
9 Main Street, Franklin, MA

YOUR STRESS-FREE GUIDE TO

Shopping for Home Loans

With this super-simple breakdown of loan types, you won't get overwhelmed — you'll find the right mortgage.

When it comes to buying a house, most people know what they prefer: a bungalow or a condo, a hot neighborhood or a sleepy street.

Mortgages, too, come in many styles — and recognizing which type you should choose is just slightly more involved than, say, knowing that you prefer hardwood floors over wall-to-wall carpeting.

First things first: To pick the best loan for your situation, you need to know what your situation is, exactly. Will you be staying in this home for years? Decades? Are you feeling financially comfortable? Are you anxious about changing loan rates? Fill in the checklist on page 9, and read "Before You Choose a Mortgage Lender" on page 29 of this guide.

Next: You'll want to have an understanding of the different loans that are out there. There are lots of options, and it can get a little complicated — but you got this. Here we go.

Mortgages Are Fixed-Rate or Adjustable, and One Type Is Better for You

Let's start with the most common type of mortgage, that workhorse of home loans — the fixed-rate mortgage.

A fixed-rate mortgage: Lets you lock in an interest rate for 15 or 30 years. (You can get 20-year loans, too.) That means your monthly payment will stay the same over the life of the loan. (That said, your property taxes and insurance premiums will likely change over time.)

It's ideal when: You want long-term stability and plan to stay put.

Here's what else you need to know about fixed-rate mortgages:

- A **30-year fixed-rate mortgage** offers a lower monthly payment for the loan amount (for this reason, it's more popular than the other option, the 15-year).
- A **15-year fixed-rate mortgage** typically offers a lower interest rate but a higher monthly payment because you're paying off the loan amount faster.

Now let's get into adjustable-rate, the other type of mortgage you'll be looking at.

An adjustable-rate mortgage (ARM):

- Offers a lower interest rate than a fixed-rate mortgage for an initial period of time — say, five or seven years — but the rate can fluctuate after the introductory period is over, depending on changes in interest rate conditions. And that can make it difficult to budget.
- Has caps that protect how high the rate can go.

It's ideal when: You plan to live in a home for a short time or you expect your income to go up to offset potentially higher future rates.

Here's what else you need to know about adjustable-rate mortgages:

- Different lenders may offer the same initial interest rate but different rate caps. It's important to compare rate caps when shopping around for an ARM.
- Adjustable-rate mortgages have a reputation for being complicated. As the Consumer Financial Protection Bureau advises, make sure to read the fine print.

A general rule of thumb: When comparing adjustable-rate loans, ask the prospective lender to calculate the highest payment you may ever have to make. You don't want any surprises.

Conventional Loan or Government Loan? Your Life Answers the Question

Which fixed-rate or adjustable-rate mortgage you qualify for introduces a whole host of other categories, and they fall under two umbrellas: conventional loans and government loans.

Conventional loans:

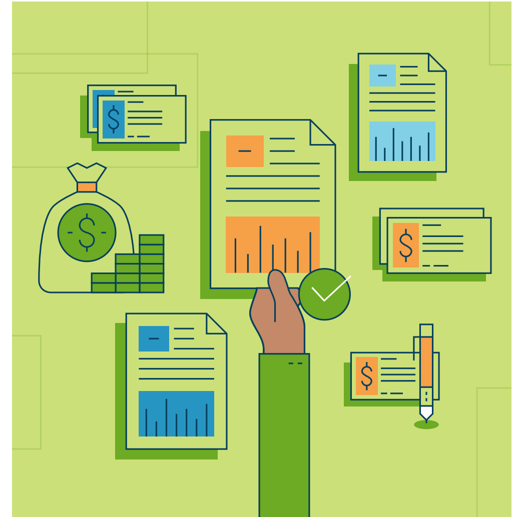
- Offer some of the most competitive interest rates, which means you'll likely pay less in interest over the period of the loan.
- Typically you can get one more quickly than a government loan because there's less paperwork.

Who qualifies? Typically, you need at least a credit score of 620 or above and a 5% down payment to qualify for a conventional loan.

Here's what else you need to know about conventional loans:

- If you put less than 20% down for a conventional loan, you'll be required to pay **private mortgage insurance (PMI),** an extra monthly fee designed to mitigate the risk to the lender that a borrower could default on a loan. (PMI ranges from about 0.3% to 1.15% of your home loan.) The upshot: The lender has to cancel PMI when you reach 22% equity in your home, and you can request to have it canceled once you hit 20% equity.

- Most conventional loans also have a maximum 43% dept-to-income (DTI) ratio, which compares how much money you owe (on student loans, credit cards, car loans, and other debts) to your income — expressed as a percentage.



Fannie Mae and Freddie Mac set limits on how much money you can borrow for a conventional loan. A home loan that conforms to these limits is called a **conforming loan:**
- In most cities, the maximum amount for a conforming loan is $453,100.
- In high-cost areas, such as New York City and San Francisco, the limit is $679,650.
- Limits are revisited annually and are subject to change based on each area's average home price.

A home loan that exceeds these limits is called a **jumbo loan:**
- Jumbo loans typically require a higher down payment (up to 30% for some lenders) and a credit score of at least 720. Some borrowers can qualify while putting down 20%, but their credit score has to be higher.
- They also tend to have stricter debt-to-income requirements, generally allowing for a maximum DTI ratio of 38%.

There are practical considerations to take into account before getting a jumbo loan too, mainly: Are you comfortable carrying that much debt? The answer depends on your current financial situation and long-term financial goals.

Government loans:
- Include loans secured by the Federal Housing Administration (FHA), U.S. Department of Veterans Affairs (VA), and the U.S. Department of Agriculture (USDA) Rural Development.
- Are meant to stimulate the housing market and enable folks who may be unable to qualify for conventional loans to still become homeowners.

Who qualifies? That depends on which government loan you're looking at.

If you've had trouble qualifying for a mortgage because of income limitations or credit:

FHA loans are used by a broad swath of people, including those with lower credit scores and income.

- You can get an FHA loan with a downpayment of 3.5% if you have a minimum credit score of 580. You can still qualify with a credit score below 580 — even with no credit score — but the down payment and other requirements will be much higher.
- FHA loans conform to loan limits set by county; these limits typically range from $294,515 to $679,650 in high-cost areas. You can view the FHA mortgage caps for your county at hud.gov.
- If you get an FHA loan, you must pay an upfront mortgage insurance premium (MIP) and an annual premium of 0.85%. Currently, the MIP is 1.75% of the loan amount — so, $1,750 for a $100,000 loan. This premium can be paid upfront at the mortgage closing, or it can be rolled into the monthly mortgage payment.

Also, a heads-up — the date an FHA loan was issued affects the MIP.

- **If you received an FHA loan on or before June 3, 2013:** You're eligible for canceling MIP after five years, but you must have 22% equity in your home and have made all payments on time.
- **If you received an FHA loan after June 3, 2013:** To stop paying MIP, you'd have to refinance into a conventional loan and have a current loan-to-value of at least 80%.

If you're in the military, a veteran, or a veteran's spouse:

- VA loans offer active or retired military (or a veteran's surviving spouse) a mortgage with a 0% down payment.
- VA loans also can have more lenient credit requirements — typically around a minimum 620 credit score — and lower DTI requirements.
- The VA only allows lenders to charge 1% maximum to cover the costs of originating and underwriting the loan, so you save money at closing. There is, however, an additional upfront, one-time funding fee of 2.15%.
- VA loan eligibility: http://www.benefits.va.gov/homeloans/

VA loans also don't charge borrowers mortgage insurance — potentially helping you save a significant chunk of cash on your monthly payment.

Given the benefits, a VA loan is often the best mortgage option for people who qualify.

If your income is limited and you live in a small or rural town:

USDA loans are mortgages for limited-income home buyers in towns with populations of 10,000 or less, or that are "rural in character," meaning that some areas that now have bigger populations are grandfathered in. You can see whether your town is eligible on the USDA's website (https://eligibility.sc.egov.usda.gov).

- USDA loans typically have lower interest rates than non-USDA loans.
- Down payments can be as low as 0%.
- USDA mortgages also have more lenient credit score requirements than conventional loans.
- Income limits to qualify depend on location and household size.
- USDA loans charge an upfront mortgage insurance fee of 1% of the loan amount and annual mortgage insurance premium of 0.35%.
- And USDA loan borrowers must buy a "modest home" — a property with a market value deemed reasonable for the area, though the USDA does not set specific price limitations.

Only a select number of lenders offer USDA loans.

If your job is to help people:

Niche programs, like the Neighbor Next Door (htttps://www.hudhomestore.com) from HUD, allow teachers, law enforcement officers, first responders, and government workers — as much as 50% off the list price — on eligible homes in revitalization districts.

Note: Downpayment assistance programs offer qualified buyers such things as grants and interest-free loans. Start with your state's housing finance agency (https://www.ncsha.org/housing-help) to find options.

Now You Know the Basics. It's Time to Call for Backup

Speaking of your lender: Ultimately, you'll be working with your loan officer or broker to narrow down these choices, and to find a loan that works for you and your finances. (Just another reason why it's important to choose a lender you're comfortable with.)

Your real estate agent should be able to offer some insight, too. And because they don't earn a paycheck from your loan selection, their advice about mortgages should be impartial.

You know your stuff. And you know whom to ask for help. Who's overwhelmed? Not you.

READ THESE TIPS

Before You Choose a Mortgage Lender

Someone out there wants to help save you time, stress, and money. Here’s how you find them.

Everyone in the market for a house has different wants — pre-war charm, a lush backyard, a welcoming front door in Pantone Ultra Violet, perhaps.

But at the end of the day, they all share a need in common: money. Lots of it. That’s where your mortgage lender comes in.

The right lender can save you time, anxiety, and loads of cash. And the right loan officer — the professional who represents the lender — can be a powerful ally when you close on a mortgage. As with any potentially life-altering partnership, it’s important to choose wisely.

Only You Know Which Lender Is Your Type

There are three types of mortgage lenders — retail banks, credit unions, and mortgage banks — as well as mortgage brokers, who compare loan products via a coterie of potential lenders to help you, the client, find the right one. Before you start narrowing down the candidates, you have to know what you’re looking for, and where to find it. Let’s talk about your options.

Retail Banks

What they are: These are your Chases and Banks of America, plus your local banks. They do their own underwriting (in a nutshell, investigating your finances), so retail banks, especially the smaller ones, can sometimes offer lower fees and less-stringent credit requirements. If you like to have your accounts all in one place, you may want to use your own bank or credit union.

Who you’ll work with:
You’ll be assigned a loan officer, who will receive a commission or bonus for writing your loan.

Credit Unions

What they are: They’re not-for-profit and customer-owned, so they’re not beholden to shareholders like a bank. Because of that and their not-for-profit tax status, they typically offer more personal service and lower fees. The flip side is less convenience: They have fewer branches and ATMs.

And to apply for a loan, you must be a member of the credit union's community, which could be faith-, employment-, interest-, or union-based, among other things. That said, it's typically not difficult to become a member; the National Credit Union Administration's Credit Union Locator (https://www.mycreditunion.gov) is a tool for finding credit unions near you.

Who you'll work with: As with a bank, you'll be assigned a loan officer, who will receive a commission or bonus for writing your loan.

Mortgage Banks

What they are: These banks, such as AimLoan and PennyMac, only offer home loans. Many online lenders like Rocket Mortgage by Quicken Loans, operate as mortgage banks.

Who you'll work with: A mortgage bank will assign you a loan officer, who will receive a commission or bonus from the lender's gross fees for writing your loan. An online lender is going to offer less hand-holding.

Mortgage Brokers

What they are: Mortgage brokers are essentially personal home loan shoppers — they act as liaisons between home buyers and mortgage lenders to help people find the lowest rates and the best mortgage terms. They're able to get home buyers the best mortgage rates because they leverage their existing relationships with lenders — something individual home buyers can't do. By doing the heavy lifting for the borrower, the idea is that they make loan shopping more convenient — and perhaps a bit faster.

Who you'll work with: A mortgage broker can be an individual agent or a group of agents, who act as independent contractors. In exchange for their services, mortgage brokers typically charge a 1% to 2% fee of the loan amount, which is either paid by the borrower or the lender at closing.

Now that you're armed with the basics, you'll want to give yourself time to weigh the options about which lender, exactly, to work with.

It Pays to Shop Around Before You Commit

Over the life of the loan, seemingly subtle differences could add up to tens of thousands of dollars. That money belongs to future you and all your dream vacations, renovations, and remodeling #goals.

So before you choose your specific lender ...

- Thoroughly research any retail bank, credit union, mortgage bank, mortgage broker, or online option you're considering. Make sure you're clear on what they can offer you. About one in five (21%) home buyers said they regret their choice of mortgage lender, according to a recent J.D. Power survey. You're doing your homework so that won't be you.

- Interview lenders. You're aiming for a shortlist of three. (You'll see why it's three in a minute.) If you're thinking about selecting an online lender, make sure to read "Your Stress-Free Guide to Shopping for Home Loans" on page 24.

- Don't be shy about seeking advice. Survey your family, friends, and coworkers — especially the ones who are nerdy about money.

- Ask your real estate agent for a second opinion. They have experience with reputable lenders, particularly in your city or town.

Now, let's say you've narrowed your list of potential lenders to at least three candidates. The next step? Finding out whether they will give you a loan.

You Should Seek Out a Lender's (Pre-) Approval, Too

There's a world of difference between being pre-qualified for a loan and being pre-approved. Pre-approval means you've got skin in the game. It means you're a boss. And it's proof that you can buy.

Besides being the grown-up thing to do, pre-approval puts you in a better position when you make an offer. Everyone takes you more seriously. Pre-approval provides evidence to your real estate agent and the seller (or seller's agent) that a trusted financial institution is willing to finance the purchase.

In most housing markets, sellers are going to expect you to be pre-approved when you make your offer. And when you're pre-approved, you're more likely to have your offer accepted — or at least, you won't lose out on a bid because you have to go back to the bank to get approved for a loan.

As for pre-qualification, it's an approximation and not necessary unless you have no clue about your creditworthiness and just want a snapshot.

By contrast, with a pre-approval, a lender typically goes deeper and tells you more specifically how big a loan you can get. Caution here: Just because the lender says you can take out a loan for an amount, doesn't mean you should. Consider your lifestyle and monthly budget to decide on the responsible loan amount for you.

To get pre-approved, you must also authorize a lender to pull your credit.

- **Borrowers with credit scores of 760 or higher** can typically qualify for the lowest interest rates.
- **Borrowers with credit scores below 650** may need to apply for a non-conventional mortgage, such as a Federal Housing Administration (FHA) loan — a government-backed loan that requires a minimum credit score of 580 but lets borrowers make as low as a 3.5% down payment.
- **Borrowers with credit scores below 580** can still qualify for FHA loans, but they'll have to make at least a 10% down payment. The lower the score, the tighter the requirements become.

It Makes Good Sense to Get Pre-Approved by at Least Three Lenders

A Loan Estimate spells out a future loan's terms, including:

- The interest rate
- The length of the loan
- Estimated costs of taxes and insurance
- How interest rates and payments might change over time
- Other important financials

By comparing loan estimates, you can effectively size up your loan options and decide which lender is best for you — and your future. (If you need help navigating the details, the Consumer Financial Protection Bureau (https://www.consumerfinance.gov) offers a sample Loan Estimate with helpful tips and definitions.)

Getting pre-approval early in the process also gives you an edge over other buyers. Here's why:

- The amount you're approved for can help you determine your price range, and thus save time and frustration when shopping.
- It sends a signal to your agent and sellers that you're serious about buying a home.
- It'll help you move quickly to make an offer when you see a home you like.

And it's an excuse to celebrate! You now have everything you need to move ahead with that one special lender — and, at the same time, connect with an officer or broker who can help you select the home loan product that's best for you.

So have a cocktail. Do a dance. Lay back and relax in one of those fancy sheet masks.
You're a (huge) step closer to getting a new house.

Contact Warren Reynolds with any questions or if you would like to be connected with a mortgage loan expert for a consultation.

508-561-6259