GENERAL FINANCING QUESTIONS

Tips for Homebuyers

1. What is a Mortgage?

Generally speaking, a mortgage is a loan obtained to purchase real estate. The "mortgage" itself is a lien (a legal claim) on the home or property that secures the promise to pay the debt. All mortgages have two features in common: principal and interest.

2. What is a loan to value (LTV)? How does it determine the size of my loan?

The loan to value ratio is the amount of money you borrow compared with the price or appraised value of the home you are purchasing. Each loan has a specific LTV limit. For example: With a 95% LTV loan on a home priced at $50,000, you could borrow up to $47,500 (95% of $50,000), and would have to pay, $2,500 as a down payment.

The LTV ratio reflects the amount of equity borrowers have in their homes. The higher the LTV the less cash homebuyers are required to pay out of their own funds. So, to protect lenders against potential loss in case of default, higher LTV loans (80% or more) usually require mortgage insurance policy.

3. What types of loans are available and what are the advantages of each?

Fixed Rate Mortgages: Payments remain the same for the life of the loan

TYPES

- 15-year
- 30-year

ADVANTAGES

- Predictable
- Housing cost remains unaffected by interest rate changes and inflation

Adjustable Rate Mortgages (ARMS): Payments increase or decrease on a regular schedule with changes in interest rates; increases subject to limits

TYPES

- Balloon Mortgage: Offers very low rates for an Initial period of time (usually 5, 7, or 10 years); when time has elapsed, the balance is due or refinanced (though not automatically).
- Two-Step Mortgage: Interest rate adjusts only once and remains the same for the life of the loan.
- ARMS linked to a specific index or margin.

ADVANTAGES

- Generally offer lower initial interest rates.
- Monthly payments can be lower.
- May allow borrower to qualify for a larger loan amount.

4. When do “ARMS” make sense?

An ARM may make sense, if you are confident that your income will increase steadily over the years or if you anticipate a move in the near future and aren't concerned about potential increases in interest rates.

5. What are the advantages of 15- and 30-year loan terms?

30-Year:

In the first 23 years of the loan, more interest is paid off than principal, meaning larger tax deductions.

As inflation and costs of living increase, mortgage payments become a smaller part of overall expenses.

15-year:

Loan is usually made at a lower interest rate.

Equity is built faster because early payments pay more principal.

6. Can I pay off my loan ahead of schedule?

Yes. By sending in extra money each month or making an extra payment at the end of the year, you can accelerate the process of paying off the loan. When you send extra money, be sure to indicate that the excess payment is to be applied to the principal. Most lenders allow loan prepayment, though you may have to pay a prepayment penalty to do so. Ask your lender for details.

7. Are there special mortgages for first time homebuyers?

Yes. Lenders now offer several affordable mortgage options, which can help first time homebuyers overcome obstacles that made purchasing a home difficult in the past. Lenders may now be able to help borrowers who don't have a lot of money saved for the down payment and closing costs, have no or poor credit history, have quite a bit of long-term debt, or have experienced income irregularities.

8. How large of a down payment do I need?

There are mortgage options now available that only require a down payment of 5% or less of the purchase price. But the larger the down payment, the less you have to borrow, and the more equity you'll have. Mortgages with less than a 20% down payment generally require a mortgage insurance policy to secure the loan. When considering the size of your down payment, consider that you'll also need money for closing costs, moving expenses, and possibly repairs and decorating.

9. What is included in a monthly mortgage payment?

The monthly mortgage payment mainly pays off principal and interest. But most lenders also include local real estate taxes, homeowner's insurance, and mortgage insurance (if applicable).

10. What factors affect mortgage payments?

The amount of the down payment, the size of the mortgage loan, the interest rate, length of the repayment term and payment schedule will all affect the size of your mortgage payment.

11. How does the interest rate factor in securing a mortgage loan?

A lower interest rate allows you to borrow more money than a high rate with the same monthly payment. Interest rates can fluctuate as you shop for a loan, so ask lenders if they offer a rate "lock-in" which guarantees a specific interest rate for a certain period of time. Remember that a lender must disclose the Annual Percentage Rate (APR) of a loan to you. The APR shows the cost of a mortgage loan by expressing it in terms of a yearly interest rate. It is generally higher than the interest rate because it also includes the cost of points, mortgage insurance, and other fees included in the loan.

12. What happens if interest rates decrease and I have a fixed rate loan?

If interest rates drop significantly, you may want to investigate refinancing. Most experts agree that if you plan to be in your house for at least 18 months and you can get a rate 2% less than your current one, refinancing is smart. Refinancing may, however, involve paying many of the same fees paid at the original closing, plus origination and application fees.

13. What are discount points?

Discount points allow you to lower your interest rate. They are essentially prepaid interest, with each point equaling 1% of the total loan amount. Generally, for each point paid on a 30-year mortgage, the interest rate is reduced by 1/8 (or.125) of a percentage point. When shopping for loans, ask lenders for an interest rate with 0 points and then see how much the rate decreases with each point paid. Discount points are smart if you plan to stay in a home for some time since they can lower the monthly loan payment. Points are tax deductible when you purchase a home and you may be able to negotiate for the seller to pay for some of them.

14. What is an escrow account? Do I need one?

Established by your lender, an escrow account is a place to set aside a portion of your monthly mortgage payment to cover annual charges for homeowner's insurance, mortgage insurance (if applicable), and property taxes. Escrow accounts are a good idea because they assure money will always be available for these payments. If you use an escrow account to pay property tax or homeowner's insurance, make sure you are not penalized for late payments since it is the lender's responsibility to make those payments.

FIRST STEPS

15. What steps need to be taken to secure a loan?

The first step in securing a loan is to complete a loan application. To do so, you'll need the following information.

- Pay stubs for the past 2-3 months
- W-2 forms for the past 2 years
- Information on long-term debts
- Recent bank statements
- Tax returns for the past 2 years
- Proof of any other income
- Address and description of the property you wish to buy
- Sales contract

During the application process, the lender will order a report on your credit history and a professional appraisal of the property you want to purchase.

The application process typically takes between 1-6 weeks.

16. How do I choose the right lender for me?

Choose your lender carefully. Look for financial stability and a reputation for customer satisfaction. Be sure to choose a company that gives helpful advice and that makes you feel comfortable. A lender that has the authority to approve and process your loan locally is preferable, since it will be easier for you to monitor the status of your application and ask questions. Plus, it's beneficial when the lender knows home values and conditions in the local area. Do research and ask family, friends, and your real estate agent for recommendations.

17. How are pre-qualifying and pre-approval different?

Pre-qualification is an informal way to see how much you may be able to borrow. You can be 'pre-qualified' over the phone with no paperwork by telling a lender your income, your long-term debts, and how large a down payment you can afford. Without any obligation, this helps you arrive at a ballpark figure of the amount you may have available to spend on a house.

Pre-approval is a lender's actual commitment to lend to you. It involves assembling the financial records mentioned in Question 47 (Without the property description and sales contract) and going through a preliminary approval process. Pre-approval gives you a definite idea of what you can afford and shows sellers that you are serious about buying.

18. How can I find out information about my credit history?

There are three major credit reporting companies: Equifax, Experian, and Trans Union. Obtaining your credit report is as easy as calling and requesting one. Once you receive the report, it's important to verify its accuracy. Double-check the "high credit limit, “total loan," and “past due" columns. It's a good idea to get copies from all three companies to assure there are no mistakes since any of the three could be providing a report to your lender. Fees, ranging from $5-$20, are usually charged to issue credit reports but some states permit citizens to acquire a free one. Contact the reporting companies at the numbers listed for more information.

CREDIT REPORTING COMPANIES

Company Name	Phone Number
Experian	1-888-524-3666
Equifax	1-800-685-1111
Trans Union	1-800-916-8800

19. What if I find a mistake in my credit history?

Simple mistakes are easily corrected by writing to the reporting company, pointing out the error, and providing proof of the mistake. You can also request to have your own comments added to explain problems. For example, if you made a payment late due to illness, explain that for the record. Lenders are usually understanding about legitimate problems.

20. What is a credit bureau score and how do lenders use them?

A credit bureau score is a number, based upon your credit history that represents the possibility that you will be unable to repay a loan. Lenders use it to determine your ability to qualify for a mortgage loan. The better the score, the better your chances are of getting a loan. Ask your lender for details.

21. How can I improve my score?

There are no easy ways to improve your credit score, but you can work to keep it acceptable by maintaining a good credit history. This means paying your bills on time and not overextending yourself by buying more than you can afford.

FINDING THE RIGHT LOAN FOR YOU

22. How do I choose the best loan program for me?

- Your personal situation will determine the best kind of loan for you. By asking yourself a few questions, you can help narrow your search among the many options available and discover which loan suits you best.
- Do you expect your finances to changeover the next few years?
- Are you planning to live in this home for a long period of time?
- Are you comfortable with the idea of a changing mortgage payment amount?
- Do you wish to be free of mortgage debt as your children approach college age or as you prepare for retirement?
- Your lender can help you use your answers to questions such as these to decide which loan best fits your needs.

23. What is the best way to compare loan terms between lenders?

First, devise a checklist for the information from each lending institution. You should include the company's name and basic information, the type of mortgage, minimum down payment required, interest rate and points, closing costs, loan processing time, and whether prepayment is allowed.

Speak with companies by phone or in person. Be sure to call every lender on the list the same day, as interest rates can fluctuate daily. In addition to doing your own research, your real estate agent may have access to a database of lender and mortgage options. Though your agent may primarily be affiliated with a particular lending institution, he or she may also be able to suggest a variety of different lender options to you.

24. Are there any costs or fees associated with the loan origination process?

Yes. When you turn in your application, you'll be required to pay a loan application fee to cover the costs of underwriting the loan. This fee pays for the home appraisal, a copy of your credit report, and any additional charges that may be necessary. The application fee is generally non-refundable.

25. What is RESPA?

RESPA stands for Real Estate Settlement Procedures Act. It requires lenders to disclose information to potential customers throughout the mortgage process. By doing so, it protects borrowers from abuses by lending institutions. RESPA mandates that lenders fully inform borrowers about all closing costs, lender servicing and escrow account practices, and business relationships between closing service providers and other parties to the transaction.

For more information on **RESPA**, click on the link below:

http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm

For a local counseling referral, call 1-800-217-6970.

26. What is a good faith estimate, and how does it help me?

It's an estimate that lists all fees paid before closing, all closing costs, and any escrow costs you will encounter when purchasing a home. The lender must supply it within three days of your application so that you can make accurate judgments when shopping for a loan.

27. Besides RESPA, does the lender have any additional responsibilities?

Lenders are not allowed to discriminate in any way against potential borrowers. If you believe a lender is refusing to provide his or her services to you on the basis of race, color, nationality, religion, sex, familial status, or disability, contact HUD's Office of Fair Housing at 1-800-669-9777 (or 1-800-927-9275 for the hearing impaired).

28. What responsibilities do I have during the lending process?

To ensure you won't fall victim to loan fraud, be sure to follow all of these steps as you apply for a loan:

- Be sure to read and understand everything before you sign.
- Refuse to sign any blank documents.
- Do not buy property for someone else.
- Do not overstate your income.
- Do not overstate how long you have been employed.
- Do not overstate your assets.
- Accurately report your debts.
- Do not change your income tax returns for any reason. Tell the whole truth about gifts. Do not list fake co-borrowers on your loan application.
- Be truthful about your credit problems, past and present.
- Be honest about your intention to occupy the house.
- Do not provide false supporting documents.

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