HOME FINANCING

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INTRODUCTION

If you are buying a house, especially your first one, you may have some basic questions about home financing. The following information may help.

WHAT IS A MORTGAGE?

A mortgage is security for the repayment of money you borrow to pay for a house. It is similar to a lien on a car you buy with borrowed money. The bank, savings and loan company, or mortgage company that lends the money is called the mortgagee. The borrower, usually you, is called the mortgagor. In some states, a mortgage is called a deed of trust. A mortgage or deed of trust must be in writing.

The lender extinguishes the mortgage you signed when you pay the debt in full. If you don't make your mortgage payments on time, or if you otherwise default on the mortgage, the lender may sue to foreclose the mortgage. A foreclosure is the sale of your mortgaged property to pay off the debt.

DO I QUALIFY FOR A MORTGAGE?

A lender will ask you about your employment, finances and information about the home you're buying (but you can be pre-approved before you choose a home).

Lenders look at your income in ways other than the total amount; how you earn it is also important. For example, income from bonuses, commissions and overtime can vary from year to year. If these sources make up a large percentage of your income, your lender will want to know how reliable they are.

Your lender will also consider the relationship between your income and expenses. Generally, your fixed housing expenses (mortgage payment, insurance and property taxes, but not repairs or maintenance) should not be more than 28 percent of your gross monthly income, although this is not an absolute rule. Your lender will also consider other long-term debts, such as car loans or college loans.

DOWN-PAYMENT AND CLOSING COSTS

A down-payment is a percentage of your home's value. The type of mortgage you choose determines the down-payment you will need. It can range from zero to 20 percent, or more if you wish.

WHAT KIND OF MORTGAGE IS BEST?

There are two major types of mortgage loans: those with fixed interest rates and payments and those with changing rates and payments. However, there are many variations of these plans on the market, and you should shop carefully for the mortgage that best suits your needs.

Common fixed-rate mortgages include 30-year and 15-year mortgages. The 30-year mortgage usually offers the lowest monthly payments of fixed-rate loans, with a fixed payment schedule. A 15-year fixed-rate mortgage allows you to own your home in half the time and for less than half the total interest costs of a 30-year loan. These loans, however, require higher monthly payments.

Mortgages with changing interest rates and/or monthly payments exist in many forms. The adjustable rate mortgage (ARM) is probably the most common, and there are many types of ARM loans available. The ARM usually offers interest rates and monthly payments that are initially lower than fixed-rate mortgages. But these rates and payments can fluctuate, often annually, according to changes in a pre-determined "index."

COMPARING FEATURES

Probably the single most important factor to look for when shopping for a home mortgage is the annual percentage rate, or "APR." The APR should include virtually all the costs of credit, including such items as interest, "points" (fees often charged when a mortgage is closed), and mortgage insurance (when included in the loan). The lower the APR, generally the lower the cost of your loan. Advertisements that state other rates such as "simple" interest rates, do not include all the costs of the loan.

If you shop for a mortgage loan with interest rates or payments that change, be sure to compare:

- Initial interest rates;
- The "cap" -- or how much the interest rate can increase/decrease over the life of the loan, and how much the rate can change at each adjustment;
- How often the interest rate can change;
- How much and how often the monthly payments and term of the loan can change;
- What index is used to determine the rate changes;
- What "margin" is used -- or how much additional a lender can add to the adjusted interest rate;
- The limits, if any, on "negative amortization" -- the loss of equity in your home when low monthly payments do not cover fully the interest rate charges agreed upon in the mortgage contract; and
- Any "balloon" payments -- a large payment at the end of your loan term, often after a series of low monthly payments.