Making Choices

What Kinds of Mortgages Are Available?

It's also a good idea to gain a basic understanding of the kinds of home mortgages that are available. As you review the list, keep in mind that these categories widely overlap — for example, a lender may provide adjustable-rate FHA loans and fixed-rate jumbo mortgages. Work with your mortgaage consultant to determine the best loan to fit your needs and design a custom financing solution.

Fixed-rate mortgages. The interest rate remains fixed for the life of the loan.

- Offer predictable monthly payments of principal and interest throughout the life of the loan.
- Provide protection from rising rates. No matter how high market rates go up, your interest rate stays the same.
- Generally well-suited to borrowers who plan to stay in their homes for a long period of time, have a fixed or slowly-increasing income, and have a lower tolerance for financial risk.

Adjustable-rate mortgages. The interest rate adjusts periodically to reflect market conditions on pre-determined dates.

- The initial introductory period usually offers a lower rate (relative to fixed-rate mortgages), after which the rate adjusts periodically, based on a market index.
- Borrowers are protected from steep increases in rates through annual and lifetime adjustment caps.
- The initial rate can be locked in for different periods. Most lenders offer introductory periods of one, three, five, seven, or ten years. Typically, the rate readjusts annually after the introductory period.
- Because of the introductory period's lower rate, some borrowers may be eligible for a larger loan amount with an ARM than with a fixed-rate mortgage.
- May be more appropriate for borrowers who may want to sell or refinance early, can afford to make larger monthly payments after the rate adjusts, or are looking to buy a home when interest rates are relatively high.

Jumbo loans. These are loans that exceed a specified size (conforming loan amounts).

- In 2006, jumbo loans on single-family homes exceed $417,000 ($625,500 in Alaska and Hawaii).
- Rates are generally higher on jumbo loans than on smaller comparable loans.

FHA Loan. The Federal Housing Administration (FHA) insures a wide variety of mortgages. These loans are designed to meet the needs of homebuyers with low or moderate incomes and feature:

- Low down payment requirements
- Loan limits based on geographic locations
- Generally more liberal qualifying guidelines
- Use of gift funds for down payment and/or closing costs.

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(continued)

VA Loans. The Department of Veterans Affairs (formerly the Veterans Administration) guarantees mortgages for qualified veterans and active-duty military personnel and their spouses who are first- or second-time homebuyers. VA loans feature:

- Low or no down payment requirements
- A wide range of rate, term, and cost options
- Flexible qualifying guidelines
- Use of gift funds for closing costs

Alternative financing. These programs are designed for borrowers with less-than-perfect credit histories, excessive debt, or previous bankruptcy, foreclosure or tax delinquency.

No Documentation Loans. Designed for borrowers who are self-employed, on commission or whose financial situation may be difficult to document. These loans allow borrowers to apply for a loan based on their credit history and stated income.

Are There Any Tips to Consider When Loan Shopping?

When you're comparing mortgage rates and programs, the following information can come in handy.

Make It a Point to Ask About Points

When inquiring about rates, be ask if the quoted interest rate reflects payment of points. Many loan programs allow you to receive a discounted interest rate by paying a fee in points or origination fees. One point equals 1% of the loan amount, and the more points you can or wish to pay, the more you can lower your rate. Paying points is not a requirement; it's just an option that lenders offer to accommodate the immediate or long-term monthly payment concerns of home mortgage customers.

The Annual Percentage Rate Is the Key

When you're shopping for a home mortgage, make sure you ask lenders for the annual percentage rate (APR) as well as the interest rate, so you compare it accurately to other available mortgage rates. In addition to the interest rate (which determines the amount of your monthly payment), the APR adds in the other costs required to make the loan to determine your loan's total finance charge, expressed as a percentage over the scheduled life of your loan. After you apply for your mortgage, you will receive a Truth-in-Lending Statement. Homebuyers often find this document confusing because it states the APR only, and not the interest rate.

Example: Interest Rate and APR Comparison:

Mortgage Program	Interest Rate	Total Points	APR
30-Year Fixed-Rate Mortgage	7.000%	1	7.170%
30-Year Fixed-Rate Mortgage	6.875%	3	7.249%

This chart is for illustrative purposes only. It assumes $1,000 in additional finance costs, a $145,000 loan, and a 20% down payment. Certain closing costs may be charged that are not included in this calculation. Actual rates vary depending on current market conditions, applicant's credit data, mortgage program and the type of property being financed.

The APR reflects the true cost of a mortgage loan over its full scheduled term as a yearly rate because, in addition to the rate of interest charged on the loan, it includes certain other prepaid finance charges. These charges may include, but are not limited to, origination fees, loan discount points, private mortgage insurance premiums and the estimated interest, prorated from closing date to month end.

In this example, the loan with lower interest rate would be more expensive option when the total points are also considered.

Locking or Floating

A lock gives you a specified period of time — from 30 to 120 days — of protection from financial market fluctuations in interest rates by setting the range of pricing available to you. Your rate may still be affected by changes in the loan's characteristics (for example, if you choose to pay fewer points or make a smaller down payment) or in your credit profile.

If you choose to float your pricing, then your rate will fluctuate with the market. The benefit to floating is that you would have the option of locking at a lower level if rates should interest rates decrease. The risk, of course, is that you would face a higher interest rate should interest rates rise before you lock.

Generally, you'll be able to lock once you have found a property and as late as up to five days before closing. Programs that allow you to lock pricing before finding a property may also be available.

When you lock, make sure the lock period allows enough time for your loan to be processed. If your lock period expires before you're ready to take ownership of the house, your loan pricing may be adjusted to reflect current market conditions.

Some loan programs allow a one-time float down option that can be used during the rate lock period. The one-time float down allows you to seek a lower rate should rates drop while your loan is locked, if you qualify.

No one knows if rates will rise or fall, so it's impossible for a home mortgage consultant to tell you whether or not you should lock or float your loan. The decision is yours.

If you are looking to build your home, some lenders provide the ability to lock your pricing for up to one year to accommodate lengthy construction time frames. You may also get this extended lock with an option to re-set your interest rate once during the rate-lock period, provided you qualify at the time you seek the new rate.