The Home Buyer Roadmap – Shop for Mortgage Rates and Terms

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We are presenting a series of articles that will layout the home buying process in detail to help you understand what you are about to go through. We are collaborating with experts in the individual fields to clarify each step in the process. This the 2nd article in the series.

Last week you got pre-qualified. You found a lender that you can trust and have already narrowed down a price range for your future home. If you don't qualify for as much of a loan as you would like you can find out from your lender what you need to do in order to qualify for more. Do you need to improve your credit score? Do you need to payoff some debt? Together with lender you can create a plan of action.

At the time of loan application your lender will explain the different loan programs, interest rates, and closing costs. The lender is required by law to give you an estimated closing cost statement called a **Good Faith Estimate**. In order to have a working knowledge of the costs involved before sitting down with your lender, let's go over some basic terms:

Upfront Costs: Traditionally, lenders expected buyers to make a **down payment** amounting to at least 20 percent of the purchase price of the house. Today, lenders have many different programs, including **100% financing**, to offer qualified buyers. To avoid mortgage insurance, lenders offer 80/20 loans, which include a 1st and a 2nd mortgage. Besides the down payment, homebuyers must be prepared to pay a number of additional up-front costs, typically called **"closing costs".** Closing costs generally range from 2 to 4 percent of the amount of the mortgage.

Ongoing Costs: Each mortgage payment includes both the repayment for a portion of the principal (the amount you actually borrowed) and the interest (a fee

for using the lender's funds). Lenders refer to payments for principal and interest as **"P & I"**. The amount for our monthly payment depends on the amount you borrow, the interest rate, the repayment period (or "term"), and whether you have a fixed-rate or an adjustable-rate mortgage.
In most cases a homebuyer's monthly mortgage payments also include an added amount for property taxes and homeowner's insurance. The lender holds this additional amount in a separate "escrow" account and then pays the taxes and insurance for the borrower. Taxes and insurance are an essential part of the homeowner's housing costs; lenders often refer to the components for a mortgage payment as **"PITI"** (for principal, interest, taxes, and insurance).

Shopping for interest rates can be confusing! The interest rate advertised may sound good, but upon further investigation the points are higher or there are other closing fees being charged to obtain that rate. Several things affect the interest rate; how many years the mortgage is, how long your rate lock is, your credit score and how many points you are willing to pay.

The longer the term of your fixed rate mortgage the higher the interest rate. For example, a 15 year loan would be approximately 5.375% today and a 30 year would be 5.875%.

An adjustable rate mortgage starts at a lower interest rate than a fixed rate loan. ARMs (adjustable rate mortgages) increase your purchasing power as the start rate is much lower. This works particularly well for a buyer who knows their income will be higher in the future, someone just graduating from college or starting a new career. Or maybe another loan will be paid off and a higher house payment will not negatively impact their finances. Be sure you know the terms and caps of the loan before making your decision.

The longer you are locked into a rate also affects your interest rate. Anything beyond a 60-day closing is considered an extended lock. Your rate will be higher as you increase your lock period.

Typically, a lender will quote you a "par" rate, which includes a 1% origination fee. The lender keeps this fee to pay the loan originator, the other staff and expenses. You can also receive a quoted rate without an origination fee. This rate will be slightly higher with the origination fee being paid through the price of the loan. (Not the borrower.)

On fixed rate loans, you can choose to buy down the interest rate by paying points. Points are basically prepaid interest. One point is equal to one percent of the loan. Is it worth paying points? This is a question that only you can answer based on how long you expect to stay in the home. The longer you stay in the home, the more likely there will be a benefit in paying the points. Your lender can help you compute if you would be ahead by paying points based on your expected time in the home.

Be sure to shop for mortgage rates and terms locally. We cannot emphasize this enough. There are plenty of terrible experiences out there of Internet deals going south at closing. Most Realtors have lenders that they can refer you to. They are not compensated for this, they just want good service for their customers and a smooth transaction.

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