Paying for your New Home

VA Guaranteed Loans – Veteran Administration loans are available to qualifying veterans of military service. VA loans are guaranteed rather than insured. The VA guarantees 25 to 50 percent of the loan and thereby protects the lender from loss. Veterans can sometimes qualify for a mortgage without any down-payment, but they still must pay a funding fee.

Conventional – These loans are neither FHA insured nor VA guaranteed. Most conventional lender s prefer a 10 to 20 percent or greater downpayment, but some require as little as 3 percent down. Lenders typically require borrowers with downpayments of less that 20 percent to purchase private mortgage insurance.

Good-Faith Estimate – The Good-Faith Estimate lists the costs you are likely to incur at the closing of your new home. The key word here is estimate. Some figures, such as accrued interest, change based on which day of the month the closing occurs.

Truth-In-Lending Disclosure – The Truth-in-Lending Disclosure shows the cost of your financing as a percentage and as a dollar amount. This form also tells you whether prepayment penalties apply and shows the charge for a late payment.

Credit Report and Verification – Your lender obtains your credit report at the time of application and may update the report prior to closing if more than 30 days have passed. The lender also verifies information on the application. You will be asked to sign verification forms covering employment, deposits, and your current mortgage company or landlord.

Appraisal – Costs vary for appraisals, but $250 to $00 is common. The appraiser determines the fair market value your completed home will have. If the appraised value and the sales price are different, the lender bases the loan amount on the lower figure.

Loan Lock – The lender promises to provide a loan to you at a quoted (locked) rate. Until you lock your loan rate, the interest rate for your mortgage can increase or decrease. To obtain the locked rate, approval of the application and the closing must occur before the expiration of the lock. Therefore you need to time your decision to lock your loan rate carefully. Locking too soon may result in the lock expiring before your home is completed. When you are ready to lock your loan, notify the lender in writing and request written confirmation. Be sure you understand all conditions that apply to your lock.

Loan Approval – At the time of application, your lender estimates the time needed to obtain approval. Add a week to this estimate and expect that some last-minute details will need your attention. The loan approval should be in writing and state clearly (a) that your loan has been approved; (b) the loan amount, type, and rate; (c) the time period for which the loan offered is valid; and (d) any conditions of approval or contingencies, such as closing on the sale of a previous home. Contingencies are common and if one or more apply to your loan approval, be certain you understand exactly what must occur to obtain final approval.

Many people find applying for a mortgage intimidating or frustrating – or both. Completing all the forms involved can take time. The feeling that your privacy is being invaded is common. You will feel less invaded if you consider the lender's point of view: what would you want to know about someone to who you were lending this amount of money?

However, getting a mortgage has its advantages. Qualifying for a mortgage enables you to buy more house than you might afford with cash on hand. Mortgage interest costs are usually tax deductible. Review the Internal Revenue Service's latest "simplified paperwork" or talk to your tax accountant. Maintain a sense of humor and keep focused on your goal – that new home for your family.

BROWN COUNTY HOME BUILDERS ASSOCIATION

811 Packerland Drive ~ PO BOX 13194
Green Bay, WI 54307-3194
(920) 494-9020
www.bchba.org

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For you, like most people, a home may be the biggest financial purchase you ever make. Predicting the cost is a guess until all choices are finalized. Information, planning, and self-discipline are your best assurance of keeping costs under control. Begin by determining how much cash you have (liquidity) and how much you can borrow.

Your Assets

List available cash such as checking and savings accounts or certificates of deposit near maturity. Will additional cash accumulate during construction? Home buyers typically need cash for loan application fees, the down payment, closing fees, and move-in expenses. Consider assets you can turn into cash, such as the equity in a home you already own. Other assets might include a cash gift from a family member, an inheritance, maturing bonds, or the cash value of an insurance policy. If you are a first-time buyer, you may also use an IRA or 401(K) loan but consult a tax professional before doing so.

Amount You Can Borrow

Mortgages come in many shapes and sizes. Fixed-rate, adjustable, FHA, VA, and so on. Some areas even have special programs for first-time home buyers. Your goal is to match a loan program to your circumstances so you can buy the home you want. Much of the mystery disappears if you are familiar with the basic terminology:

Pre-qualifying – Smart buyers today request an informal review of their financial positions to determine how much money they can borrow. While pre-qualifying does not obligate you and a particular lender to do business together, it can establish your budget, identify financial details that might interfere with your plans (such as an error on your credit report), and help you compare loan programs. Pre-approval requires formal application and partial processing of your mortgage application.

Many lenders use computer programs to match your financial and credit data to the requirements of various loan programs and identify those that fit your circumstances. The amount you can borrow is based on factors such as your assets, how much you owe, your income, and the length and stability of your employment. A change in your circumstances may affect the amount, the rate, and the type of loan for which you can qualify. If you fail to qualify for the amount you want, find out what changes might qualify you for a larger loan. Consider omitting some items now (a deck or finished basement) and adding them to your home later. And finally, talk to other lenders; programs and requirements vary. Some mortgage programs may penalize those who shop for the best deal because of the number of recent requests for their credit information, so be ready to explain all of the activity on your credit report. If you have spoken to more than one or two lenders, ask each lender how this situation might affect your ability to get a loan at the lowest rate.

Loan Application – Assemble the required financial documents and information prior to your application. Your lender can provide a list of needed items. Read any documents and ask any questions before you sign them. You should receive a copy of each document you are asked to sign. Expect to pay for a credit report and an appraisal when you submit the application.

Downpayment – The downpayment is the difference between the price of the home and the amount of the loan you obtain. The deposit you give to the builder and items you pay for during construction may count toward the down-payment. If you own the lot upon which your home will be built, its appraised value will be considered part of the downpayment. Be certain you understand the builder's contract regarding potential refund of your downpayment.

Closing Costs – Charges associated with the transfer of ownership make up your closing costs. They are often estimated at 2 to 3 percent of the loan amount but can vary from state to state.

Fixed-Rate Mortgage – With a fixed-rate mortgage the interest rate stays the same through the term of the loan. The 30-year, fixed-rate mortgage is popular because of its stability. A 15-year, fixed-rate mortgage pays of the loan in the shorter time and accumulates equity faster because you make a higher monthly payment.

Adjustable Rate Mortgages – If the interest rate on a mortgage can be changed, it is an adjustable rate mortgage (ARM). ARMs are easier to qualify for because their initial low interest rate results in a lower payment. Based on the terms of the loan, the rate can be adjusted up (or down) over the term of the loan – usually in 1-year increments. Rate caps limit how much the interest rate can change at one time and over the life of the loan.

Balloon Mortgage – Some lenders offer loans that mature before the loan is fully amortized. For instance a 7-23 loan comes due after 7 years, but it may have an option to renew for 23 additional years at a predetermined rate if the borrower meets certain requirements.

Origination Fee – Lenders typically charge an origination fee. This fee pays the lender for the services of the loan officer and staff who process your loan application.

Discount Points – These points are a one-time charge sometime levied by the lender. You may use points to achieve a lower permanent interest rate because you pay some of the interest in a lump sum up-front at the closing.

Principal, Interest, Taxes, and Insurance (PITI) – Mortgage payments are made up of principal, interest, taxes, and insurance. The principal and interest are calculated based on loan amount, interest rate, and term of the loan. In the early years most of your monthly payment applies to interest, and it reduces the loan principal only slightly. A portion of your mortgage payment may be set aside in an escrow account to pay your local property taxes and your homeowner's hazard insurance. This insurance usually covers theft, fire, wind, hail, and other catastrophic damage to the structure.

Ratios – Lenders consider three ratios in mortgage processing:

- The housing expense or front-end ratio. (Divide your proposed monthly mortgage payment by your gross (before tax) monthly income. If your monthly income is $4,000 and the proposed monthly mortgage payment is $1,000, you have a front-end or housing expense ratio of 25 percent. A typical limit for this ratio ranges from 28 to 33 percent.)
- The debt or back-end ratio (Add your total debts and obligations including mortgage, car, furniture, student loans, child support, charge card debt, and so on. Divide this total by your gross monthly income. Lenders typically use a limit of 36 percent. FHA-insured loans use 41 percent. Compensating factors, such as a large savings balance or a highly energy-efficiant home, can affect these guidelines
- The loan-to-value ratio (If a home appraises for $100,000 and the loan program permits an 80 percent loan-to-value ratio, a qualified borrower can obtain an $80,000 mortgage. The remaining 20 percent comes from the buyer's downpayment.)

FHA Insured Loans – The Federal Housing Administration does not lend money; it insures mortgage loans. Some FHA programs require as little as 3 percent down, although maximum loan amounts limit the loan amount available by area. The cost or premium for FHA mortgage insurance is normally added to the loan and paid over the life of the mortgage.