CHAPTER 5

Finding a Mortgage

Mortgage Search

Failing to shop comparatively among local mortgage sources can be costly. For example, the difference between a five and six percent interest rate on a $100,000 fixed rate mortgage could save about $63 per month and nearly $22,600 over 30 years.

Selecting the best mortgage is not an easy task. Among the factors to consider are your current and projected income, your marginal tax bracket, current market conditions, the size of your investment portfolio, and how long you plan to live in the house.

To make a good decision about the best mortgage for you, basic knowledge of current mortgage alternatives is needed first. Then, you will need to find a lender and analyze available financing options. All mortgages of the same type are not exactly alike.

The lender will likely be a loan originator who then sells your loan to a secondary market mortgage buyer. The originator will have the promissory note prepared along with the mortgage or deed of trust drawn to secure the property for the lender should you default on the loan.

Mortgage Sources

Traditional home mortgage lenders consist of savings and loan associations, banks, and independent mortgage brokers and are the most readily available sources of mortgage loans. A mortgage broker is a “middle” person who finds a mortgage lender for a potential borrower, and vice versa. A broker does not lend money but matches lenders with borrowers. A broker earns a commission or fee when a loan is made between parties he or she has brought together.

Credit unions offer the same kinds of mortgage products, rates, and terms as are available from traditional mortgage lenders.

Search Methods

Here are some ideas on how you might locate your mortgage options and narrow the list to a few prospects.

Internet

One way to check current mortgage rates in your area is through the Internet. At http://www.bankrate.com, you can personalize your search and find what local lenders are offering based on the type of loan you want.

Local real estate agents

Local real estate agents often are an excellent source of current information about mortgage rates and terms. Most agencies survey all major lenders in town every week or two as a service to their clientele. Here again, the information gathered is probably not enough to make a good choice.

If you cannot get a comprehensive mortgage report, invest the time to call several financial institutions for their rates and basic credit terms. Use the lender comparison sheet on pp. 49-50 of this chapter and contact various types of lenders (including savings and loans, banks, mortgage companies, and credit unions) to compare current offers.

Types of Mortgages

Today’s mortgages are complex, and home ownership is no longer a nearly risk-free investment. It is recommended to compare mortgage alternatives to find the best balance of risk and opportunity. Figure out which loan has the most advantageous combination of interest rate, up-front costs, tax advantages, monthly payment, and terms for your situation.

Conventional Mortgage
A conventional mortgage is a loan made by a private lender that is not insured or guaranteed by the federal government. Generally, if a borrower pays less than twenty percent of the purchase price for a down payment, the lender will require the borrower to pay for **private mortgage insurance (PMI)**. This insurance protects the lender against potential loss if the borrower defaults on the loan. Because PMI reduces the risk to the lender, lenders may consider larger loans and smaller down payments than would otherwise be practical. PMI annually costs between .03 and 2.25 percent of the mortgage amount and is paid monthly with your mortgage payment. Generally, conventional loans are available with down payments as low as three percent.

Under the Homeowners Protection Act, mortgage lenders are required to automatically terminate PMI when the mortgage balance reaches 78 percent of the original purchase price, known as 78% loan-to-value, provided the borrower is in good standing and has not missed any scheduled mortgage payments. The lender also is required to discontinue PMI at the halfway point of the amortization schedule, even if the mortgage balance has not yet reached 78% loan-to-value; on a 30-year loan, this would be 15 years. This is referred to as final termination.

Federal Housing Administration (FHA) Insured Loans
The Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) insures loans made by a lending institution, such as a mortgage company, bank, or savings and loan association for up to 96.5 percent of the property value and for up to 30 years. The loans finance homes in both urban and rural areas. Though the typical FHA-insured loan is a fixed-rate mortgage, they do insure other types of mortgage loans, such as adjustable rate mortgages. The interest rate is established by the market, not the government. FHA-insured loans are readily available, but some of the different types of FHA-insured loans may not be available locally.

An origination fee can be charged for up to one percent of the loan amount and there are no restrictions from paying points. The maximum loan amount may be capped, except for certain high-cost areas, which allow for larger loan amounts. There are no limits on family income and no subsidies on the monthly payments.

Advantages
- Allows for a lower down-payment
- Requires a minimum credit score of 580
- Some closing costs may be financed in the loan
- No prepayment penalties may be collected

Disadvantages
There is a **mortgage insurance premium (MIP)** that is typically financed in the loan. For FHA loans, the borrower is required to pay two premiums. The first is the upfront premium, which is 1.75% of the loan amount when the borrower gets the loan; this is included in the closing costs. The second is the annual premium, typically one percent of the loan amount paid monthly. Due to program changes in 2013, borrowers who pay less than a ten percent down payment will be required to pay the MIP for the life of the loan; unlike PMI on a conventional mortgage, they will not be permitted to discontinue MIP payments once they have reached 78% loan-to-value. This will add to the overall cost of the loan.

Veterans Administration (VA) Guaranteed Loans
Veterans Administration (VA) guaranteed loans provide mortgage insurance for a portion of low- and no-down-payment loans to eligible veterans, active duty personnel, and unmarried surviving spouses. Local lenders (not the government) supply the loans. VA loans are either fixed- or adjustable-rate loans with a repayment period of up to 30 years and 32 days.

The VA home loan limit is the maximum amount of money you can borrow using a VA-backed home loan without paying a down payment. If you qualify for a VA-backed home loan, you will receive a **home loan entitlement**. This is the maximum amount the VA will guarantee to pay to the lender if you default on your loan. If you qualify for a loan based on your income and credit history, and the property's value is not less than its asking price, your lender likely will agree to loan you up to four times the amount of your entitlement without a down payment. This is your loan limit. You may still be able to borrow more than your loan limit if you are able and willing to pay a down payment. Most lenders require your entitlement, down payment, or a combination of both to cover at least 25% of your total loan amount.

You may qualify for two types of entitlements. As the **basic entitlement**, the VA guarantees to pay the lender up to at least $36,000, or 25% of the loan

amount, whichever is less, if you default on your loan. So, your loan limit would be $36,000 × 4 = $144,000. If you want to buy a house that costs more than $144,000, the VA will help you determine your bonus entitlement; this is based on the Federal Housing Finance Agency's current national conventional financing confirming limit and your state's county loan limits. The VA will guarantee 25% of your loan amount, based on these loan limits. Your lender or the VA regional loan center, https://www.benefits.va.gov/HOMELOANS/contact_rlc_info.asp, can assist you with questions about your entitlement.

The VA does not require a down payment if the purchase price or cost of the property does not exceed the appraised value. However, the lender may require one. The VA charges a funding fee based on the type of loan received, military category, if you are a first-time loan user, and if you make a down payment. This fee is a percentage of the loan amount. The fee may be included in the loan and paid from loan proceeds. Specific information about the funding fee can be found at https://www.va.gov/housing-assistance/home-loans/funding-fee-and-closing-costs/.

If using the VA guarantee, the buyer is responsible for the following closing costs (which can be negotiated with the seller): VA funding fee, loan origination fee, loan discount points, credit report and payment of any credit balances or judgments, VA appraisal fee, hazard (homeowner's) insurance and real estate taxes, state and local taxes, title insurance, and recording fees. The seller is required to pay for real estate agent commissions, brokerage fees, buyer broker fees, and the termite report. Brokerage fees should not be charged to you for the loan.

VA loans can be paid off at any time without penalty. Partial payments cannot be less than one monthly installment or $100, whichever is less.

If you are interested in applying for a VA home loan, the first step is to apply for a Certificate of Eligibility. This confirms for your lender that you qualify for the VA home loan benefit. For Certificate of Eligibility application information, please visit https://www.va.gov/housing-assistance/home-loans/how-to-apply/.

Advantages

- Eligible veterans pay no mortgage insurance premiums and may obtain a 100% loan-to-value mortgage (no down payment), up to a fairly high loan limit.
- No minimum credit score is required.
- There is no maximum land value to the loan amount and no pre-payment penalty.

Disadvantages

- Non-veterans are ineligible.
- Discount points are usually charged, and if a seller pays them, the price of the house may be higher.
- The little or no-down-payment option results in both larger debt and heftier monthly payments. If the home depreciates, the housing debt may exceed the value of the house, and the sale of the home would not cover the loan.
- Any down payment, closing costs, or points cannot be borrowed; they must be paid in cash from the borrower's own funds. Processing time is 30 days.

For detailed information about VA Guaranteed Loan Program, visit https://benefits.va.gov/homeloans/documents/docs/vap_26-4_online_version.pdf

USDA Rural Development – Housing Loans

USDA Rural Development provides loan guarantees for purchasing rural property to qualified low- and moderate-income applicants. To qualify for the loan guaranty, the applicant's adjusted family income must not exceed 115% of the median income for the area, they must personally occupy the home as their primary residence, they must have the legal ability to take on the loan obligation, they have to have a good credit history, they must not have been suspended or barred from participation in federal programs, and the property must meet all program criteria. Applicants must purchase or build in an eligible rural area as defined by Rural Development. Loans are guaranteed with 30-year fixed-rate mortgages.

Applications are submitted for this program through an approved lender. Rural Development offices are located throughout the state. To learn more about this program or to find the office nearest to you, visit the Rural Development Web site at https://www.rd.usda.gov/page/state-offices.

Advantages

- These loans make home ownership possible to those who perhaps could not otherwise obtain adequate housing.
- The interest rate and down payment vary with household income.
- Closing costs are low.
- No minimum credit score is required.
- Loan terms may be arranged for longer terms than for conventional mortgages.

Disadvantages

This type of home financing is available only to those who meet the criteria outlined by Rural Development.

Types of Mortgages by Interest Rate Treatment

Long-term, Fixed Rate Mortgage (FRM)

Fixed rate mortgages (FRM) are the most commonly used loan. These types of loans could be federally back by FHA or the VA or be a conventional loan. With an FRM, the payments are stable, and the interest rate is fixed for the term of the loan. FRM loans are most commonly available in 15- and 30-year terms. However, 20-, 40- and 50-year terms are available.

Advantages

- The fixed payment (principal and interest) protects against inflation, which helps with long-term financial planning because you know what your housing expense will be over time.
- Offers protection from any increase in the interest rate and you know exactly how much interest you will pay over the term of the loan.
- An FRM without a prepayment penalty allows you to shorten the term of the loan and lower the amount of interest paid if extra payments toward the principal are made.
- Creates a potential long-term tax advantage, as the interest paid on the mortgage is tax-deductible if you itemize on your federal tax return.

Disadvantages

- The interest rates on an FRM are usually higher than adjustable rate mortgages and will not go down during the term of the loan.
- Because the interest rate is higher, you may not qualify to borrow as much money due to the money needed to pay for interest.
- Private mortgage insurance (PMI) is required unless the borrower pays a down payment of 20%.
- There is a slow equity build-up, especially in the early years because the majority of your monthly payment is applied to the interest.
- FRMs cannot be assumed by subsequent buyers because lenders want to take every opportunity to replace a low-rate loan with a higher-interest one.
- To take advantage of declining interest rates, you will have to refinance. Refinancing costs total about three to four percent of the loan amount, so it does not pay to frequently refinance.
- The most suitable borrowers for FRMs include those who have fixed incomes, plan to live in the home for at least five years, cannot risk future increases in monthly payments, seek long-term deductions, and believe that interest rates will rise.

Types of Fixed-Rate Mortgages

30-Year Fixed-Rate Mortgage

Advantages

- You can borrow money on a long-term basis with an interest rate that will not change.
- Monthly payments are lower because they are amortized over a longer period.
- The lower monthly payments free up money that borrowers can pour into investments that yield more than their home.
- It increases the amount you can deduct at tax time.

Disadvantages

- The overall interest bill is much higher because of the longer amortization term.
- The interest rates are higher than on shorter term loans (e.g. 15-year loans.).

15-Year Fixed-Rate Mortgage

Advantages

- Allows you to own your home debt-free in less time and for half the total interest cost of a 30-year fixed-rate loan.
- Borrowers build equity much more quickly due to a shorter amortization schedule.
- Overall interest bills (because principal balance is reduced more quickly) are dramatically lower than those on longer-term loans.
- The interest rates may be lower than on 30-year loans because you are repaying the principal more quickly.

Disadvantages

- Monthly payments can be significantly higher (roughly 15-30%) than those on 30-year loans.
- Restricts home buyers to a smaller house than they might be able to afford due to a higher payment.
- Because principal balance is paid down faster, total mortgage-interest is reduced, affecting the tax shelter benefit of owning a home.

Bi-Weekly Fixed-Rate Mortgage

Advantages

- It speeds up amortization.
- Reduces total interest paid.
- Shortens the term of the loan to about 25 years.

Disadvantages

- Lenders and private companies usually charge for this service. The same objective can be accomplished through a 30-year fixed-rate loan by making an extra payment or two a year and applying it towards the principal. However, be aware of any prepayment penalties that may exist on the loan.
- You trade saving money in total interest for losing potential tax cost reductions if you itemize deductions on your tax return.

Interest-only Fixed-Rate Mortgage

Interest-only fixed-rate mortgage terms are divided into two periods: the first period payment is smaller because you are paying interest only and no principal; in the second period, you pay both interest and principal. You build no equity during the interest-only period, since you are not paying down the principal.

Adjustable Rate Mortgage (ARM)

Adjustable Rate Mortgages (ARMs) also may be called variable-rate loans, adjustable-rate loans, or adjustable-mortgage loans. Whatever they are called, the interest rate on an ARM can move upward or downward, usually causing changes in the monthly payment. In some cases, the loan term and/or principal may change. Most ARM rates start lower with an initial fixed-rate period and move to a variable rate after a specified time.

The interest rate is based upon a recognized financial index, such as the one-year U.S. Treasury securities yield. The margin is the percentage amount added to the index rate to get the ARM's interest rate. For example, say, the index rate is six percent and the margin is two percent, the annual percentage rate (APR) of the ARM would be eight percent. To lure in customers, the starting rate of an ARM may be less than the index plus margin. However, be aware this rate is temporary and will most likely rise.

ARMs come with caps, which limit the amount both the rate and payment can adjust. There are three caps that are generally set with an ARM: periodic rate cap, lifetime cap, and payment cap.

- The **periodic rate cap** limits how much the rate can change at any one time. These are usually annual caps or caps that prevent the rate from raising more than a certain number of percentage points in any given year.
- The **lifetime cap** limits how much the interest rate can rise over the life of the loan.
- The **payment cap** is offered on some ARMs. It limits the amount the monthly payment can rise over the life of the loan in dollars, rather than how much the rate can change in percentage points.

Payment caps can cause "negative amortization" when the interest rate is higher than what the payment cap will allow. Because the capped payments are not enough to cover the interest due on the loan, the unpaid interest is added to the principal balance. ARMs which allow negative amortization and ARMs without rate caps are very risky but are generally avoided by lenders today because of the high default rates associated with them.

Advantages

- The initial interest rate is lower than a fixed rate loan (usually by one to two percent), but when interest rates are high the difference may be three to four percent.
- As a result, monthly payments start out much smaller and qualifying for an ARM is much easier.
- If interest rates fall, the ARM rate also falls, meaning greater savings without having to incur the high costs of refinancing.

Disadvantages

- If interest rates rise, then the loan rate and monthly payments will rise accordingly on the adjustment dates.
- If your income does not keep pace with the rise in payments, you could be forced to incur the costs of refinancing to obtain an FRM at the current higher rate for protection against further increases.
- Long-term (30-year) ARMs have slow equity build-up, similar to an FRM.

Other Characteristics of ARMs

The Number System

ARMs start with a fixed rate and monthly payment for a specified time period then switch to an adjustable rate and payment for the remainder of the loan term. There are several options such as 3/1, 5/1, 7/1 or 10/1. The first number (such as 5) is the number of years for the fixed rate. The second number (such as 1) is how often the ARM is adjusted after the initial period. For example, with a 5/1 ARM, the interest rate stays the same for the first five years and then can adjust once a year up to the allowable cap. The amount it can adjust to depends on the caps that are set with the ARM.

Interest-only ARMs

With an interest-only ARM, the borrower is required to pay only the interest for a specified period, often 10 years. After that, it adjusts to the going interest rate as tracked by a specified index. The loan then amortizes at an accelerated rate. During the interest-only period, the borrower can choose to pay some principal. By providing flexibility in the size of monthly payments, interest-only mortgages often are a good match for people with fluctuating monthly incomes (i.e., salespeople who are paid by commission).

Conversion ARMs

Some ARMs are "convertible" to an FRM at the prevailing rate for a much smaller fee than the cost of refinancing (sometimes as little as $100). Conversion is generally allowed only during certain years of the loan. Lenders may offer a range of interest rate-discount point combinations from which to choose.

ARMs are best suited for a buyer who expects to own the home for less than five years, accepts the risk of future higher rates (in return for immediate use of extra cash that would have gone into higher FRM payments), believes interest rates are declining, and doesn't want a higher-rate FRM. Consumers must live with the risk of higher future payments to receive initial short-term savings and potential longer-term savings if they are able to refinance and get a lower fixed rate later.

Balloon Reset/Refinance Mortgages

Balloon/reset mortgages offer monthly mortgage payments based on a 30-year amortization schedule with a choice of a five- or seven-year term to either pay off the loan or "reset"/refinance the mortgage to a current market interest rate for the rest of the amortization period. Balloons can be fixed-rate or adjustable-rate loans.

You do not have to re-qualify for the loan when refinancing. However, the refinance option is not automatic, so you must exercise the option. There are a few conditions on the option to refinance:

- You still own and occupy the home.
- You have made all mortgage payments within the past year on time.
- There are not any liens on the property.
- You may have to pay closing costs and lender fees to refinance.

Advantages

- Interest rates on balloons are generally lower than the going rates on 30-year fixed rate mortgages.
- Buyers who plan on living in the home less than the balloon term will pay less than they would with a 30-year fixed rate loan.
- The refinance option provides a "safety net" in case a planned relocation doesn't take place or economic conditions prevent you from moving to another home.
- It is possible to qualify for a larger loan amount with a balloon/reset mortgage than with a fixed-rate mortgage.

Disadvantages

- If your financial situation changes at the end of the balloon term (i.e., a decline in income or a family medical problem, etc.), you may have difficulty refinancing into an acceptable new mortgage.
- You could lose your right to refinance by falling behind on payments or allowing a lien to be placed on the property.
- Interest rates could be higher at the time of refinancing and you could be turned down.
- You could be charged closing costs and other lender fees to refinance the loan.

Questions to Ask When Choosing a Mortgage

Once you have completed the mortgage search, narrow your list to the two or three most appealing mortgages and make a thorough investigation and analysis.

Questions to Ask for Mortgage Comparison

Answers to the following questions are your tools for making a comparative mortgage analysis and a way to reduce your risk and increase your opportunity for savings.

What is the simple interest rate and number of discount points?
Discount points are a form of interest which is paid up front at closing. Each point equals one percent of the loan amount. Most lenders offer a choice of interest rates and discount points – the lower the interest rate, the more points charged. For example, if you pay two points, or $4,000, to borrow $200,000—you have really borrowed only $196,000. However, you will pay back the full $200,000 face value of the loan plus interest. Generally, the longer you plan to stay in your home, the greater the advantage of paying more points to get a lower interest rate.

What other rate/point combinations are available?
One point lowers the annual percentage rate (APR) one-fourth of one percent on the interest rate of a 30-year fixed-rate mortgage. For example, the APR of a 6% 30-year fixed-rate loan with no points is equivalent to the APR of a 5% loan with four points. An additional consideration is that (for new loans only, not refinancing), points are fully tax deductible in the year paid (unless they are financed) if you itemize deductions on your federal tax return.

What is the annual percentage rate (APR)?
The APR considers all costs of financing including the interest, discount points, mortgage insurance, etc., and amortizes them over the full term of the loan. This gives you an easy way to compare mortgages, if you keep that loan until you pay it off. If you don't intend to stay in the home that long, the APR becomes biased and is not the best basis for comparison.

Will you lock in the interest rate until closing?
The loan approval process typically takes from three to eight weeks, (or longer if applications have backed up). If not "locked in," the mortgage interest rate could change (upward or downward) before closing. Generally, lenders will lock in rates for 30 days, while some may lock in for a longer period. To extend the locked-in rate, applicants will have to pay a fee, typically a small percentage of the loan amount. Some lenders allow you to lock in by telephone at any time during loan processing. This is advantageous when market rates fall.

What is the required down payment? What will mortgage insurance cost?
Most mortgages require a 20% down payment unless you pay for mortgage insurance to protect the lender in case you default. Getting mortgage insurance can reduce your down payment to as little as three percent of the home's appraised value.

Private mortgage insurance (PMI) rates for conventional loans vary by amount of down payment and credit score. It may be cheaper than Federal Housing Administration (FHA) rates for borrowers with good credit. PMI is generally paid monthly. For FHA loans, you are required to pay two mortgage insurance premiums. The first is the upfront premium, which is 1.75% of the loan amount when the borrower gets the loan. The second is the annual premium (paid monthly), typically one percent of the loan amount.

Is there an application fee? If so, is it refundable?
Some lenders have no application fee. Others may charge upwards of $300 and may or may not refund it if the loan is not approved or if you decide not to take the loan. Compare application fees of different lenders as you consider your financing options.

What are the closing costs?
The closing costs can total three to six percent of the loan amount. Lenders are required to give you a Loan Estimate outlining the terms and projected costs of the loan. This estimate may include the origination fees (for making the loan), title changes, and items (such as insurance and taxes) which must be paid at closing. There may be additional expenses that are not listed on the form and some of the fees may be paid by either the seller or buyer. Ask the lender about any other possible closing costs, in addition to those on the standard form.

In general, the actual closing and document preparations may be conducted by an attorney or a title insurance company (usually at no additional charge if the title insurance is purchased from them).

Are there any prepayment penalties?
Today, most mortgages do not charge penalties for prepayment of principal. This is important if you later decide to sell your home or if you want to make extra payments to shorten the loan term. However, loans with prepayment penalties may have lower finance costs. Such a loan may be a good choice if you do not intend to pre-pay or sell the home within the penalty period.

Is the loan assumable?
An assumable loan can be passed on to the buyer of your home if you sell. It may or may not guarantee the same interest rate. Either way, the closing costs on

an assumed loan are less than for a new loan, so that characteristic of a loan may help you sell your home in the future.

Today, fixed rate mortgages are rarely assumable. They have a "due-on-sale" clause. However, most adjustable rate mortgages are assumable.

Is there a late payment charge?
Most lenders charge a late payment fee, but they vary in how much is charged and when the fee is imposed. The average fee is four to five percent of the monthly payment amount and imposed after the 15th of the month if payment is due on the first day of the month.

Adjustable Rate Mortgage (ARM) Questions
Is the initial interest rate discounted? If so, when and how will the interest rate ever change?
Some lenders (and builders) may offer very low initial interest rates to attract borrowers. At the end of a time span, the interest rate is raised to its normal level according to the loan agreement's formula.

Unless you intend to have the mortgage for only a short time, it is better to make comparisons based on the "formula" interest rate rather than the initial rate. However, if you plan to sell soon, the savings from the initial discounted interest rate can mean substantial savings for you.

How often can the interest rate and payment amount change?
In general, the shorter the rate adjustment period, the lower the interest rate and vice versa. Frequent adjustments are advantageous when rates are falling but offer less protection when rates rise.

What is an adjustment index and when is it used?
The interest rate of an adjustable rate mortgage follows a published market "index." Indexes based upon U.S. Treasury securities reflect true economic conditions. Indexes based upon "cost of fund" to financial institutions nationwide reflect what financial institutions must pay to attract deposits.

In general, indexes tied to long-term indicators (such as three-year and five-year securities) are less risky than those tied to short-term indicators (such as three-month Treasury bills). Long term is advantageous when rates are rising; short term is better when rates are falling.

What is the margin?
The margin or spread above the index determines what your mortgage interest rate will be at each adjustment date. The smaller the margin, the closer your interest rate is to the index rate and the less you pay. Remember that the same margin over two different indexes may produce two different interest rates—if the indexes are different.

Are there periodic, lifetime, or payment rate caps?
Rate caps limit how much the interest rate can rise or fall at the adjustment dates, over the life of the loan, or the amount the payment can increase. In general, the lower the rate caps, the smaller the risk, but the higher the starting interest rate. Most ARMs today have 5-7% lifetime rate caps and 1-2% annual rate caps.

It is a good idea to figure out or ask the lender to provide what happens to the monthly payment amount if: (a) rates rise to the upper limits of the caps (the "worst case scenario") and (b) if rates drop two or three percent. This provides a clear picture of the risk and the realistic opportunity for savings if rates fall.

Is negative amortization possible?
If interest rates rise, payment caps (limits on your monthly payment) can cause your debt to grow instead of shrink. Loans which allow your debt to grow (negative amortization) are low rate because of their high risk. However, loans with payment caps can be structured with rate caps to avoid negative amortization.

Construction Loan

When you build a home, there are two loans involved: a construction loan and a home mortgage. A construction loan covers the contractor's expenses in building your home, including purchase of the supplies. A construction loan is set up at a lending institution. Ask your lender how they handle the two loans. The construction loan must be paid off before the permanent home mortgage loan begins. Be sure you inspect your home very carefully before you sign off on your construction loan.

You are responsible for paying the interest on the construction loan while the house is being built. The construction loan interest rate could be different than the permanent mortgage interest rate. Because of that, the risk is greater for interest rates to rise with new construction. The loan period ranges 45 - 60 days depending on the lending institution. The nearer your house is to completion, the more the contractor needs to draw from the construction loan at the bank.

As with any other loan, there are closing costs. You need to be aware that, in building a house, there are **up-front** or out-of-pocket costs.

Lending institutions require:

- House plans
- Specifications
- Contract with contractor

Be sure you have a **lock and key** contract with the contractor, and you understand what that is. If changes are requested after signing the contract, it usually will cost you more. This is a set amount of what the house will cost, **not a cost plus** or other plans.

Find out who pays for the electric line to the property, wells, septic tank, walkways, driveways, grass, and cleanup. Budget for possible additional costs or include them in your contract with the contractor.

Special Programs

No- or Low-Down Mortgage Options

Lenders may offer financing up to 100% of the appraised cost of a home. With no- or low-down mortgages, you will pay as high as three percent down and as little as $500 towards closing costs.

A no-down mortgage consists of two mortgages: the first mortgage covers up to 80% of the home price, and the second covers the remaining up to 20%; you essentially are borrowing the down payment. Another feature of no- or low-down mortgages is they do not require private mortgage insurance because you are paying the down payment with the second mortgage. The catch with these types of mortgages is that they usually have higher rates of three to four percent. Ask your lender about no- or low-down financing options.

State Housing Initiatives Partnership (SHIP) Housing Assistance Program

SHIP is a down payment-assistance loan program that assists first-time home buyers with the purchase of a home. This program is designed for very low-, low-, and moderate-income households that do not have adequate resources for down payment and closing costs.

How the program functions varies from county to county within the state of Florida. The program provides a low- or interest-free loan to reduce down payment and closing costs to qualified, eligible homebuyers. A second mortgage is placed on the property and the recapture of SHIP funds are either deferred until point of sale, transfer, or refinancing, or forgiven after a specified time period. Maximum loan amounts vary based on available funds and meeting income requirements adjusted for family size. The maximum sales price, funds available, and recapture of funds are determined by the local management of the SHIP program.

SHIP funds may be matched with private funds, bank loans, credit union loans, Community Development Block Grant (CDBG) Funds, Rural Economic Community Development funds, or any other state or federal grant.

Advantages

- Provides down payment and closing cost assistance for very low- to moderate-income families.
- The loan is deferred with little or no interest. It is either forgiven after a specified time, or payable if the house is sold, refinanced, or the title is transferred.

Disadvantages

- Must qualify by local income guidelines.
- Fund availability is limited.
- Must live in the county/city limits of the program administering the funds.
- Home must be owner-occupied.

Other First-Time Homebuyer Financing Programs

The Florida Housing Finance Corporation offers a variety of programs for first time homebuyers. These include 30-year, fixed rate first mortgage loans through participating lenders and second mortgage programs to assist borrowers with down payment and closing costs.

The Florida Assist (FL Assist) Program

The Florida Assist is a down payment assistance program that provides up to $7,500 for down payment and closing costs.

The Florida Assist Loan is a zero-percent interest, non-amortizing second mortgage loan, which means you do not make any monthly payments on the amount borrowed. You repay the loan in full if you sell the home, transfer ownership, satisfy or refinance the first mortgage, or cease to occupy the home.

The Florida Homeownership Loan Program (FL HLP) Second Mortgage
The FL HLP is a down payment assistance program that provides up to $10,000 for down payment and closing costs.

The FL HLP is a three percent interest rate, fully amortizing second mortgage loan with a 15-year term. You make monthly payments. The remaining unpaid principal balance (UPB) is deferred, except in the event of the sale, transfer of deed, satisfaction of the first mortgage, refinancing of the property or until such time as the mortgagor(s) ceases to occupy the property as his/her primary residence at which time, the FL HLP Second Mortgage will become payable, in full.

Since the FL HLP Second Mortgage carries a monthly payment, this payment may need to be considered in a borrower's debt-to-income (DTI) ratio when credit underwriting.

Florida First Program
This program offers a 30-year fixed rate loan to borrowers who qualify for a bond loan. Qualified borrowers automatically qualify for the Florida Assist program. This program is available only for FHA, VA, and USDA-Rural Development loans.

FL HFA Salute Our Soldiers Military Loan Program
This program offers a 30-year fixed-rate first mortgage loan to borrowers who are active duty military and veterans. This program can be combined with other Florida Housing down payment and closing cost assistance programs.

Florida Housing Finance Agency (FL HFA) Preferred Conventional Loan Program
This program offers a 30-year fixed-rate mortgage. Qualified first-time home buyers also qualify for the Florida Assist program.

Florida Housing Finance Agency (FL HFA) Preferred PLUS Conventional Loan Program
This program offers a 30-year fixed-rate loan. Qualified first-time home buyers also automatically qualify for a 3% or 4% second mortgage, which offers three or four percent of the sales price to be used towards down payment and closing costs. The second mortgage is forgiven at the rate of 20% per year over a five-year term.

For more information about these housing programs, or to find the lenders who work with these programs in your area, visit http://www.floridahousing.org.

Other Mortgage Features
Other mortgage features are Assumable Loans and Seller Financing. Assumable mortgages, such as VA and FHA loans, allow a buyer to take over a seller's original mortgage. The buyer must then obtain a loan for the balance of the purchase price. If lenders agree to an assumption, they may review the new buyer's credit history and adjust the interest rate of the loan to current market conditions. Many fixed-rate mortgages written since the late 1970s contain a "due-on-sale" clause, however, which prohibits an assumption. This protects the lenders when buyers want to assume sellers' existing low-rate mortgages.

With seller financing, a seller provides all or part of a buyer's first and second mortgage. While sellers may offer a slightly below-market interest rate, they may also require a balloon payment of the entire loan balance within a few years of refinancing at market rates. To eliminate possible pitfalls, seller-financed loans should be prepared and reviewed by an attorney.

Other options include balloon, reverse annuity, shared appreciation, and renting with an option to buy.

Sources: https://www.va.gov/housing-assistance/home-loans/

https://www.floridahousing.org/

WORKSHEET: Shopping for a Mortgage

Description	Option (1)	Option (2)	Option (3)
Lender			
Contact name			
Phone number			
Website			
Loan Amount Needed	$	$	$
Types of Mortgages Available (FHA, USDA)			
Interest Rate			
Points			
APR			
Rate Lock-in • After loan approval or at application? • Written agreement? • For how long? • Covers rate and points?			
Loan Terms Available			
Fees			
Application			
Origination			
Credit Report			
Document Preparation			
Underwriting			
Appraisal			
Survey			
Courier			
Flood Certification			
Assumption (if applicable)			
Lender's Attorney			
Title Search and Insurance			
Other			
Are Escrows Required for Taxes and Insurance?			
Minimum Down Payment • With PMI • Without PMI			

Description	Option (1)	Option (2)	Option (3)
If PMI is required: • Upfront cost • Monthly premium • Automatically canceled when?			
Prepayment Penalty: • Yes or no? • If yes, how long is it in effect?			
Is the Loan Assumable?			
Application Options • In-person • Phone or fax • Online			
Payment Options • Monthly • Bi-weekly • Automatic • Other?			
Is payment data reported to national credit bureaus?			

Look for warning signs of a possible "predatory" lender:

- Prepayment penalty of five years or longer
- Requires credit life insurance premium be added to the mortgage loan amount or paid as a lump sum at closing
- Does not report your mortgage payment history to the three national credit bureaus

Reference: https://www.bankrate.com/mortgages/removing-private-mortgage-insurance/