Greater Boston

FIRST TIME HOMEBUYER E-BOOK

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YOUR ROADMAP FOR BUYING YOUR FIRST HOME

Buying a home is a major milestone and one of the most important decisions you'll ever make. It's an exciting experience that ultimately opens a new chapter in your life, but it can also be intimidating and even overwhelming. First-time home buyers deserve all the help they can get, which is why the team at RateGravity has put together this guide. We want you go into the home buying process feeling as confident and prepared as possible, so we've collected answers to many of the most frequently asked questions as well as our best advice.

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RATEGRAVITY:
The Mortgage Service that Puts You First

RateGravity is a better way to find the right mortgage for you. We use smart, modern technology to save borrowers tens of thousands of dollars in short-and long-term home financing costs.

- We collect each prospective borrower's information in the most efficient and least invasive manner possible. With this information, we're able to tell you not only whether you'll be approved for financing, but also exactly how much you can afford to borrow.

- We provide complete transparency into the range of interest rates available for your specific needs and then give you exclusive access to a network of fully vetted lenders who offer preferential terms.

- As a RateGravity customer, you are assigned a non-commissioned personal mortgage expert and also have access to RateGravity's on-demand mortgage concierge service.

In short, RateGravity brings clarity to a complex and confusing industry that favors lenders, not borrowers. Because we're not a lender, we're able to provide truly unbiased advice and help you make decisions that are truly in your best interests.

THE PATH TO HOME BUYING SUCCESS

Follow these 10 steps to achieve your dream of homeownership

1. EDUCATE YOURSELF

Congratulations! You've taken the first step.

2. UNDERSTAND YOUR CREDIT

It's not as hard as you think.

3. DEFINE YOUR BUDGET

How much do you need to put down?

How much can you afford each month?

4. DETERMINE WHAT YOU WANT

Which type of property?

Which towns?

What kinds of features and amenities?

5. GET PRE-APPROVED

Consult with a mortgage professional

A Pre-approval letter positions you to make an offer

6. FIND YOUR DREAM HOME

A Real Estate Agent can serve as your guide

7. MAKE AN OFFER

8. SELECT A LENDER

Loan terms vary by lender, so search for the best deal

9. GET APPROVED FOR FINANCING

The typical loan approval process takes 30-45 days

10. CLOSE THE DEAL

TOP FIVE FIRST-TIME HOMEBUYER MISTAKES

You'll save yourself a lot of time, money, and stress if you can avoid these 5 pitfalls.

1. GOING WITH THE FIRST LENDER

When it comes to mortgage rates, it's important to shop around. Rates can vary as much as 0.5% between lenders. That may sound small, but over the life of a loan it translates into tens of thousands of dollars.

2. ASSUMING YOU CAN'T AFFORD THE DOWNPAYMENT

Don't let the idea of having to put 20% down, hold you back. There are a number of payment alternatives that can make purchasing a home a reality..

3. CREATING A BUDGET THAT'S TOO TIGHT

It's tempting to base your monthly mortgage payment on the maximum amount you can afford, but you should always leave some wiggle room for the inevitable additional expenses that arise with homeownership.

4. WAIVING CONTINGENCIES TO INCREASE YOUR OFFER'S APPEAL

Waiving contingencies may seem like a good way to motivate a seller, but it's a big financial risk and you'll increase your stress level as a buyer.

5. OPENING NEW LINES OF CREDIT WHILE THE MORTGAGE IS IN PROCESS

The appearance of new debt on your credit report after applying for a mortgage increases your debt-to-income ratio. This can also lower your credit score and negatively impact your mortgage approval.

BOSTON METRO:

A Hot Market

High demand + Low inventory =
A Seller's Market

New construction is not keeping pace with population growth

Migration of young professionals to urban areas

Supply of homes is at 5-yr low
Inventory is 1/3 of 2012 levels

Price appreciation in Boston has made it a sellers market
Home prices are up ~33% over past 5 years

Median sale price in Spring 2017 (May 2017)=400k vs.
Spring 2012 (May 2012)=300k

Median home only on market for 11 days

5th most expensive city to rent a one or two bedroom apartment in.
Average Rent in Boston is $2,866

$2,866

AVERAGE RENT IN BOSTON

11

DAYS MEDIAN HOME IS ON MARKET FOR

RENT VS. BUY

One of biggest financial decisions adults make
To Rent or To Buy? 5 Things to Consider:

1. HOW LONG DO YOU PLAN TO STAY?

Buying a home is typically a smart investment, but it does require that you put money down up-front. If you don't stay in your home long enough, the value may not appreciate enough to offset the initial cost of investing.

2. ARE YOUR FINANCES STABLE ENOUGH TO HANDLE THE UNPREDICTABLE HOUSING MARKET?

Contrary to popular assumptions, home prices don't always go up. Make sure you have the financial flexibility to wait out slow or non-existent home appreciation.

3. HOW IMPORTANT IS IT TO YOU TO SAVE RATHER THAN SPEND?

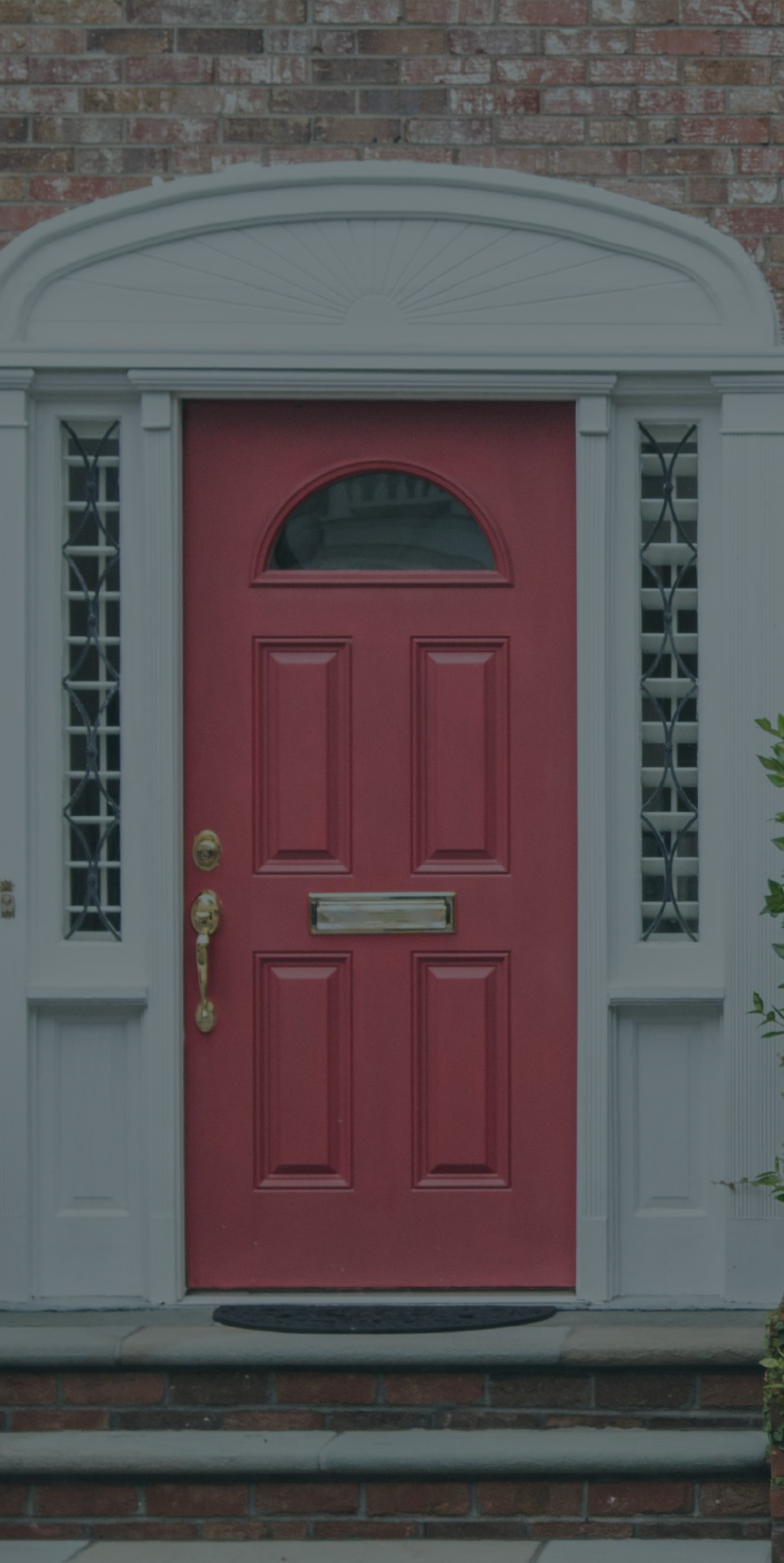
Home ownership builds equity and adds to your overall net worth. Renting, on the other hand, does not grow your equity, but may be a less expensive option.

4. HOW MUCH WILL YOU SAVE ON TAXES?

The home mortgage interest deduction allows taxpayers who own their homes to reduce their taxable income by the amount of interest paid on their loan. It's important to consult with a tax professional to understand how much you're eligible to save.

5. CAN YOUR INCOME SUPPORT HOME OWNERSHIP COSTS ABOVE AND BEYOND YOUR MONTHLY MORTGAGE PAYMENTS?

There's more to owning a home than mortgage payments. Ongoing maintenance expenses and annual taxes, for instance, can add up quickly.



THE FOUR MOST COMMON PROPERTY TYPES

Understanding the Differences

SINGLE FAMILY RESIDENCE

A mortgage loan secured by a property that contains one residential dwelling unit.

Considerations:

- SFRs are the lowest risk property type, so loans on a SFR come with the lowest rates (lowest risk = lowest rates)
- Typically there are many comparable properties, so the purchase price of a SFR is more likely to match the appraised value of the home than other property types.

CONDOMINIUM (CONDO)

A unit in a condominium project. Each unit owner has title to his or her individual unit, an individual interest in the project's common areas and, in some cases, the exclusive use of certain limited common areas.

Considerations:

- There are a limited number of lenders who will lend on non-warrantable condos
- A non-warrantable condo is a property in which the loan is not eligible for sale to Fannie Mae or Freddie Mac because it is perceived to be a more risky property type (e.g., condos where the majority of units in an association are rentals).
- Condos are considered higher risk than SFRs, and therefore loans for condos come with higher interest rates.
- The homeowner's association (HOA) fees associated with condos increases the buyer's monthly payment.

MULTI-FAMILY

Properties that provide separate housing units for two or more families, although they secure only a single mortgage.

Considerations:

- Multi-family homes sometimes require larger down payments than single unit homes
- Rental income (if there is already a signed lease) or the potential for rental income (the amount will be determined in the appraisal report) will be included in your monthly income when your lender qualifies you for a loan

TOWNHOUSE

A property type typically constructed with common walls bordering the adjacent units. The property owner not only owns his or her unit, but also an undivided interest in any common area. In some cases, a townhouse owner owns the physical structure rather than just the space inside the walls, like a condo owner.

Considerations :

- Townhomes, like condos, may not be eligible for sale to Fannie Mae or Freddie Mac and therefore your options for lenders will be limited

In some cases, "townhouse" can simply be a term to reference the style of the structure rather than the form of ownership.

HOW MUCH HOME CAN I AFFORD?

For most people, home affordability ultimately depends on the answer to the question: how much is a bank or mortgage company willing to lend to me?

THE AMOUNT A BANK OR MORTGAGE COMPANY IS WILLING TO LEND TO YOU DEPENDS ON TWO PRIMARY FACTORS:

1. How much money you personally contribute to buy your home (i.e. your "down payment")
2. How much money you make relative to your debts

HOW MUCH MONEY YOU CONTRIBUTE TO BUY YOUR HOME

The reason lenders care about how much money you "put down" is because it lowers the amount of money they need to lend you to purchase your home. Furthermore, the more money you put down, the less likely you are to stop making your payments since you have more "equity" into the transaction.

Hypothetically speaking, in a scenario where your financial circumstances deteriorate, if you only put 10% down, you are more likely to stop making payments than somebody who put 30% down, because you have less money to lose. This is why lenders provide better terms to borrowers who make larger down payments.

Lenders quantify the amount you are willing to put down using a ratio called the Loan-to-Value Ratio (LTV), which is calculated as follows:

LOAN-TO-VALUE RATIO = LOAN AMOUNT / APPRAISED VALUE OF THE PROPERTY

In order for you to get the best terms on your loan, lenders will require that you put at least 20% of your own money into the transaction, resulting in an 80% LTV. There are programs where you are able to put as little as 3% down, but to qualify for these programs, you will be required to make additional monthly payments to pay for an insurance policy that will protect the lender.

HOW MUCH MONEY YOU MAKE RELATIVE TO YOUR DEBTS

Lenders care about how much money you make relative to your debts because they need to be sure you have the capacity to make your mortgage payment every single month. Lenders measure this with the Debt-to-Income ratio (DTI), which is calculated as follows:

THE DEBT-TO-INCOME RATIO = TOTAL MONTHLY DEBT OBLIGATIONS/GROSS MONTHLY INCOME

Your total monthly debt obligations will include your mortgage payment along with the taxes and insurance payments associated with the property you are buying. Lenders get an accurate account of your other monthly debt obligations by requesting a credit report from the credit bureaus, which list all your monthly debt obligations.

A DTI at or below 43% is typically accepted by all lenders. Calculating this ratio can become more complex if you derive income from multiple sources (e.g. rental properties) or your income can vary (e.g. commission and/or bonus income). If your DTI is more than 43%, you will likely need to lower your monthly debt obligations to lower the ratio to below 43%.

Getting approved for a home loan involves many more factors than the aforementioned ratios. Though, before you can even begin the process of thinking about buying a home, you need to know how much you can afford. Understanding these two ratios is a critical first step to figuring this out.

HOW INCOME IMPACTS LOAN QUALIFICATION

BACKGROUND

One of the criteria used by lenders to determine if you qualify for home financing is your debt-to-income (DTI) ratio. This formula helps lenders determine if you have the capacity to meet your monthly debt obligations, including your mortgage payments. To qualify your loan, lenders consider the total income that you receive.

WHAT YOU NEED TO KNOW

Lenders will require you to prove a minimum history of two years of employment income. Income that has been received for a shorter period of time may be considered as acceptable income, as long as your employment profile demonstrates that there are positive factors to reasonably offset the shorter income history.

If you rely on overtime or bonus income for qualifying purposes, you must have a history of no less than 12 months for it to be considered stable

DOCUMENTATION REQUIREMENTS FOR BASE PAY, BONUS AND/OR OVERTIME

Two most recent paystubs, and
IRS W-2 forms covering the most recent two year period.
Please note that if a Lender is uncertain about your income, they can independently contact your employer to verify employment. To document this, they will complete a Fannie Mae form 1005 – Request for Verification of Employment ("Written Request of Employment" – WVOE).

Lenders are also required by Agency guidelines to complete a Verbal Verification of Employment (VOE) for each of your employers within 10 days of closing to ensure you are still employed in the same manner as you stated in the loan application.

JOB CHANGES

If you have recently changed positions with your employer, it is up to the lender to determine the effect of the change on your eligibility and your opportunity to receive bonus or overtime pay in the future. As a result, lenders are likely to request that your employer complete a WVOE to validate the impact of this change. However, in some instances, a WVOE is not sufficient and this can be cause for a lender to omit the income from your qualifying calculations.

If you have historically been employed on a part-time basis, but you will now be working full-time, the lender must obtain written confirmation from your employer in order to include the income in your qualifying calculations.

BASE INCOME CALCULATION GUIDELINES:

After the applicable income documentation has been obtained, the lender will calculate the borrower's eligible qualifying base income. The following table provides guidance for how a lender will calculate income:

HOW OFTEN PAID	HOW TO DETERMINE MONTHLY INCOME
Annually	(Annual gross pay) / 12
Monthly	Use monthly gross payment amount
Twice Monthly	Twice monthly gross, pay x 2 pay periods
Bi-Weekly	(Biweekly gross pay x 26 pay periods) / 12 months
Weekly	(Weekly gross pay x 52 pay periods) / 12 months
Hourly	(Hourly gross pay x average # of hours worked per week x 52 weeks) / 12

Lenders will compare all of the above calculations with the documented year-to-date base,earnings (and past year earnings, if applicable) to determine if the income amount appears to be consistent

MILITARY INCOME:

Military personnel may be entitled to different types of pay in addition to their base pay. Flight or hazard pay, rations, clothing allowance, quarters' allowance, and proficiency pay are acceptable sources of stable income, as long as the borrower can prove that the particular source of income will continue to be received in the future.

Income paid to military reservists while they are satisfying their reserve obligations also is acceptable if the borrower can prove it is stable and will continue for at least 3 years.

YOUR DOWN PAYMENT EXPLAINED

Background

A down payment is the personal cash contribution that a borrower makes in a purchase transaction. While programs exist for down payments as low as 3% for one-unit primary residences (0% for active US military and veterans), the best loan terms available for one-unit primary residences come with down payments of at least 20%. If a borrower is to put less than 20% down, lenders will require that the borrower secure subordinate financing or private mortgage insurance.

For other Occupancy Types (i.e. second homes and investment properties) the down payment required to be eligible for financing may exceed 20%, depending on the number of units and product type.

What You Need to Know

MORTGAGE INSURANCE

Lenders will require that borrowers secure mortgage insurance with down payments less than 20% for one-unit primary residences. This insurance protects the lender in the event of a loan default and can be paid upfront or in monthly installments. There are also options whereby the lender will pay the mortgage insurance premium on behalf of the borrower, however this will result in a higher interest rate on the loan.

SUBORDINATE FINANCING

For down payments of less than 20%, borrowers can avoid mortgage insurance by combining a first mortgage with a second mortgage (aka subordinate financing). In some instances, this may result in better terms than mortgage insurance. A common structure for subordinate financing is the 80-10-10, where the "80" refers to the percentage of funds provided by the first mortgage, the first "10" refers to the percentage of funds provided by the second mortgage and the final "10" refers to the borrower's down payment.

The second mortgage or subordinate financing typically consists of a variable rate home equity line of credit (HELOC) or a fixed rate loan. The rate on the second mortgage is higher than the rate on the first mortgage to compensate the subordinate lender for the additional risk associated with a smaller down payment.

BORROWER'S OWN FUNDS

Certain lenders may require that a borrower contribute at least some of their own funds as the down payment instead of getting the entire amount in the form of a gift from a relative. Loans that meet Fannie Mae guidelines with a down payment gift of 20% or more do not require a minimum borrower contribution.

WHAT IS A CREDIT REPORT?

Your credit report is a synthesis of your credit accounts, payment histories, accounts referred to collections, inquiries into your credit file, and public financial records, such as bankruptcies. All of this history is collected and documented by a consumer reporting agency. The three largest and most frequently used nationwide consumer reporting agencies are Equifax, Experian, and TransUnion.

Based on the information in your credit report, each of these agencies also assigns you a credit score – a number that represents how likely you are to repay a debt. Lenders use your credit report and credit score to determine your eligibility for credit and to set pricing for loans based on your credit risk.

A lender who is considering approving you for a loan will obtain and thoroughly review a credit report for each borrower on your loan application. Some of the most important elements they will look at include:

NUMBER AND AGE OF ACCOUNTS

Lenders first identify whether you have an established credit history or have only recently begun building your credit. They also look to see whether you have opened a significant number of accounts recently. (It's better to have a mix of new and older accounts.)

Credit histories that include older, more established accounts generally represent lower credit risk, however if your report shows a significant number of recently opened accounts, lenders may worry that you are overextended, and represent a higher credit risk.

On the flip side, a less established credit history does not automatically mean lenders will consider you a higher credit risk. If you're making payments on time to your newly opened accounts, you'll score better than someone who fails to make payments on their older, established accounts.

PAYMENT HISTORY

To ensure you aren't flagged as a high credit risk, your credit history needs to be free of late payments, collection or charged-off accounts, foreclosures, deeds in lieu, and other public records information such as bankruptcies, judgments, and liens. The greater the number of such incidences and the more recently they occurred, the higher your credit risk.

When it comes to late payments, recent ones are more detrimental to your credit than ones that occurred more than 24 months ago. Lenders also look closely at payments that were 30, 60, 90 or more days past due to determine whether the late payments represent isolated incidents or a pattern of poor financial management.

Lenders also evaluate delinquent payments in the context of your overall credit history, including the number and age of accounts, credit utilization, and recent attempts to obtain new credit. For example, while it might not be a deal breaker if your credit history includes a few delinquent payments, if your report also includes recent credit inquiries and high balances-to-limits ratio, lenders are more likely to consider you a high credit risk.

CREDIT SCORE

Your credit score is a numerical value that ranks you based on your credit risk at a given point in time. The figure, which ranges from 300 to 850, is calculated using a statistical evaluation of the information in your credit file, and has proven to be predictive of loan performance. When the term "credit score" is used by Fannie Mae, it refers to the classic "FICO" score developed by Fair Isaac Corporation.

MINIMUM CREDIT SCORE REQUIREMENTS

Each lender has its own minimum credit score requirements, but in general very few lenders approve loans for borrowers who have credit scores below 620.

REPRESENTATIVE CREDIT SCORE

The representative credit score for your mortgage loan is determined based on the credit scores of each borrower listed on your application, and is used to determine loan eligibility and interest rate.
In the typical scenario, the lender obtains three credit scores – one from each of the primary consumer reporting agencies – and uses the middle score as the "representative" credit score, (e.g., 703, 710, and 680 = 703). If the lender is only able to obtain two scores, they use the lower one, (e.g. 700, 680 = 680).

If there are multiple borrowers, the lender uses the applicable credit score for each borrower and then select the lowest from that subset to use as the representative credit score for the mortgage.

CREDIT PULL

Lenders often refer to ordering your credit report as "pulling your credit." When a lender pulls your credit, it is considered a "hard pull" and it merges the data from all three consumer reporting agencies. Too many hard pulls of your credit can negatively impact your credit score because most credit scoring models look at how recently and how frequently you apply for credit. Too much activity can make a lender think that you are overextended.

Other services, like RateGravity, conduct "soft pulls," which allow them to review your credit file, including your existing accounts,without negatively affecting your credit score.

TAKE CONTROL OF YOUR CREDIT SCORE

Follow these five simple tips to improve your credit score.

1. CHECK YOUR CREDIT REPORTS AND REPORT ANY ERRORS

Visit annualcreditreport.com to check the accuracy of your report and ensure its accuracy.. 25% of credit reports contain errors that could have a negative effect on consumer credit scores.

2. EXTEND YOUR CREDIT HISTORY

Not having enough history on your credit report can count against you. One way you can lengthen your history is to have a family member designate you as an authorized user on an existing credit card.

3. KEEP CREDIT CARD BALANCES BELOW 30% OF CREDIT LIMITS

Just because you have credit doesn't mean you should use it. Spending more than 30% of your available credit results in a poor "credit utilization ratio," which can lower your score even if you're consistently paying balances on time. On the other hand, credit utilization ratios under 10% tend to result in higher credit scores.

4. ELIMINATE CREDIT CARD BALANCES

Your credit score is based in part on how many of your cards have balances, so paying off and closing out credit cards that have small outstanding balances can help your score.

5. ALWAYS PAY ON TIME

It may be easier said than done, but be consistent about making your monthly payments on time. It's critical. A single missed payment can lower your score by as much as 100 points, and that's a big deal.

TYPES OF HOME LOANS

There are four home loan categories, and several variations within those categories. Understanding the differences between these options makes you a smarter consumer and helps you choose the right loan product for your specific situation.

CONFORMING LOANS

Conforming loans are the most typical, accounting for nearly 60% of all U.S. loans. To qualify as a conforming loan, the borrower, property, and loan amount must meet standard guidelines set forth by the government agencies, Fannie Mae and/or Freddie Mac.

The maximum loan amount for a conforming loan is $424,100, however exceptions apply to certain parts of the country where home values are significantly higher than the national average (e.g., Suffolk County in Boston).

The term "conforming" should not be confused with the term "conventional." Conforming loans are a subset of conventional loans. In fact, any loan that is either insured or guaranteed by the US Government is considered "conventional."

NON-CONFORMING LOANS

This is a somewhat confusing term because itseems to imply there is something wrong with these loans. However, the term simply denotes that these loans are not eligible for sale to Fannie Mae and/or Freddie Mac because they do not meet these agencies' standard eligibility guidelines.

The most popular loan in this category is a "jumbo" loan, which is nonconforming because the loan amount is greater than the agencies' loan limit guidelines allow. Because jumbo loans are not sold to the agencies, they are added to a lender's balance sheet as an asset. For this reason, they are often held to more rigorous qualification requirements.

GOVERNMENT LOANS

The qualification parameters for government loans are set by a government agency separate from Fannie Mae and Freddie Mac. In addition, all three primary types of government loans are either insured or guaranteed by the government.

- **FHA** – Administered and insured by the Federal Housing Authority, these loans offer down payments as low as 3.5%. Given the low down payment requirement, borrowers pay an upfront and ongoing insurance premium to protect against defaults. Loan sizes are subject to county limits based on home values in that county relative to the U.S. average.

- **VA** – Administered and guaranteed by the Veterans Association, these loans offer low or no down payments, but are only available to current or former members of the military. Borrowers pay a fee (referred to as a "funding fee") for the privilege of accessing VA loans and like FHA loans the borrowing limits vary based on the county.

- **USDA** – Administered by the Department of Agriculture, these loans cater to low and moderate income families living in rural areas. They are subject to income limits and allow for low or no down payment. Like with VA loans, borrowers pay an upfront fee (referred to as a "guarantee fee").

SUBPRIME LOANS

Subprime loans for borrowers who cannot qualify for any of the other loan types because of poor credit or some other limiting factor, such as a recent bankruptcy or foreclosure.

GOVERNMENT LOANS				
	Administered by	Benefits	Fees and Restrictions	Loan Limits
FHA	The Federal Housing Authority	Down payments as low as 3.5%	Upfront and ongoing mortgage insurance to protect lenders against default	Subject to county limits based on home values in that county relative to the U.S. average
VA	The Veterans Association	Low or no down payment	Only available to current or former members of the military Borrowers pay a fee referred to as the "Funding fee" to access VA loans	Subject to county limits based on home values in that county relative to the U.S. average
USDA	Department of Agriculture	Low or no down payment	Cater to low and moderate income families living in rural areas Subject to income limits Borrowers pay a fee referred to as the "Guarantee Fee" to acces USDA loans	Subject to county limits based on home values in that county relative to the U.S. average

FIXED RATE VS. ADJUSTABLE RATE MORTGAGES

There are two types of mortgages that you should be familiar with before choosing the mortgage that is best for you: Fixed Rate Mortgages and Adjustable Rate Mortgages. Understanding the difference between these types of mortgages is the first step in making this important financial decision.

FIXED RATE MORTGAGE

Fixed rate mortgages feature interest rates that remain the same over the life of the loan (e.g., 30 years). This means that the principal and interest payment will also remain fixed for the life of the loan.
A longer term fixed rate loans is a good choice if you intend to remain in your home for more than ten years or are planning to hold and lease your property.

On the other hand, if you can afford to pay your mortgage down in fewer than twenty years, a shorter term fixed rate loan may be the best option. Shorter term, fixed rate loans come with lower interest rates , but because you are paying the loan down over a shorter period of time, your monthly payment will be higher than a longer term fixed rate loan.

ADJUSTABLE RATE MORTGAGE (ARM)

An ARM is a loan with an interest rate that changes periodically, usually in relation to an index, and payments may go up or down. The most common ARMs are called "hybrid" ARMs because they contain both fixed and adjustable rate components.

The basic features of an ARM are:

Initial Rate and Payment

The initial rate and payment amount on an ARM will be fixed for a specific period as stated in the terms of the loan (e.g., on a "5/1 ARM," the initial rate remains in effect for the first five years).

Adjustment Period

After the initial, fixed rate period, the interest rate and monthly payment can increase or decrease. The "1" in the 5/1 ARM refers to how frequently an ARM rate can change after the initial fixed period, in this case once per year. So a 7/1 ARM has a 7 year fixed initial period followed by annual adjustments up or down.

Index and Margin

The interest rate on an ARM during the adjustment period is calculated using two numbers: the index and the margin. The index is a benchmark interest rate that is set by a third party and changes based on general market conditions. Your lender will confirm which index applies to your loan when you submit your application, but it is typically the one-year London Inter-Bank Offer Rate (LIBOR) or one-year US Treasury.

The margin is an interest rate premium that the lender adds to the index. The margin is set by the lender when you apply for the loan, and it stays the same over the life of the loan. The margin plus the index is referred to as the "fully indexed rate."

Interest Rate Caps

Caps (sometimes called "limits") dictate the maximum amount your interest rate can increase. If the index rate moves up, your interest rate will also move up. However, the total amount your interest rate can go up is limited by the "cap" associated with the loan.

If interest rates go down, your interest rate could go down. However, not all ARMs adjust down. Some ARMs have "floors" which prevent the rate from dropping below the stated floor amount, and often this floor is equal to the margin.

The lender sets the cap and/or floor when you apply for the loan.
There are two types of interest rate caps:
1. The "periodic adjustment" cap limits the amount your interest rate can adjust up or down from one adjustment period to the next, and
2. The "lifetime" cap limits the total interest rate increase over the life of the loan.

Let's look at a hypothetical example of how an ARM works:

Loan Terms:

- 5/1 ARM
- Initial rate: 4.0%
- Adjustable rate: LIBOR (the index) + 2.00% percent (the margin)
- Periodic adjustment cap: 2.00%
- Lifetime cap: 6.00%

In this case, 5/1 means that the initial rate of 4.00% will be fixed for the first five years, and the rate will adjust every year starting in year six.

Let's assume that at the beginning of the sixth year of your loan, the One-Year LIBOR index is 3.0%. This means that your new rate at the first adjustment will be 5.0%. Here's the math:

3.0% (LIBOR) + 2.00% (margin) = 5.00% (fully indexed rate)

Your rate will adjust again each year for the life of the loan. Let's now assume that at the beginning of the seventh year of your loan the LIBOR is 4.5%. Your new rate would be 6.00%.

4.5% (LIBOR) + 2.00% (margin) = 6.00% (lifetime cap comes into effect here)

While 4.5% + 2.00% actually equals 6.50%, because the lifetime cap is 6.00%, the fully indexed rate cannot go above 6.00% at any point during the life of the loan. So, even when the sum of the LIBOR and the margin exceed this cap, the terms of the loan ensure that your rate never exceeds 6%.

WHY YOU SHOULD CONSIDER AN ADJUSTABLE RATE MORTGAGE

The 30-year fixed rate mortgage is the most popular mortgage in the U.S. However, this is not the optimal loan for all borrowers. Let's go over why an adjustable rate mortgage might be the best mortgage for you.

In the U.S., the average life of a loan is approximately six years because many people opt to sell their home or refinance within that timeframe. Knowing that, you may wonder why you'd want a 30-year mortgage. If you're asking this question and don't have a good answer, an ARM might be right for you.

HOW CAN AN ARM HELP YOU SAVE MONEY?

Let's break down two hypothetical scenarios for a $400,000 loan:

	Interest Rate	Estimated Life of Loan	Principal Paid over 7 Years	Interest Paid over 7 Years
Fixed Rate Mortgage	30-year rate: 4.00%	6 Years	$46,810	$90,530
Adjustable Rate Mortgage	7/1 ARM rate: 3.00%*	6 Years	$54,075	$67,213

You can see that by going with a 7/1 ARM, you'd contribute an additional $7,265 and change in principal payments and you save $23,317 in interest payments.

But, what if you plan to stay in your home for longer?
If you choose to stay in the same loan for longer than seven years, your adjustable rate (and monthly payment) can go up or down, but because the upward adjustments are limited by a cap, your rate will never exceed a certain interest rate so you can model out the worst case scenario to determine which type of mortgage is best for you.

And if your situation changes and you decide to stay in the property for longer than you'd initially planned, you always have the option to refinance into another ARM or a fixed rate loan at that time.
If interest rates go down, your interest rate could go down. However, not all ARMs adjust down. Some ARMs have "floors" which prevent the rate from dropping below the stated floor amount and often this floor is equal to the margin.

* ARMs are able to offer lower rates because the lender does not have to factor in the risk that the loan will potentially exist for 30 years at the same interest rate. Adjustable rate mortgages protect lenders from the risk of having a loan fall below market rates in the future.

LOAN APPROVAL PROCESS

Once your offer has been accepted, and you've chosen your lender, the next steps in the process are all about getting your loan approved:

1. REVIEW LOAN OPTIONS (INCLUDING CLOSING-COST SCENARIOS)

Popular loan options include 30-year fixed, 5/1 ARM, 7/1 ARM, and 10/1 ARM

Borrowers can pay the closing costs or get the lender to cover the costs with a "lender credit." If you accept a lender credit, you'll be subject to a higher interest rate.

2. LOCK IN THE TERMS OF YOUR DEAL (INTEREST RATE AND CLOSING COSTS)

You'll want to lock in your interest rate for the number of days until your closing. The typical time from loan application to loan closing is 45 days

3. COMPLETE AN APPLICATION

All lenders use a uniform application called a Fannie Mae 1003.

4. SIGN THE DISCLOSURES

Most lenders offer you the opportunity to e-sign.

5. PROVIDE CREDIT DOCUMENTS

Typical credit documents include W2s, paystubs, bank statements, and retirement account statements.

6. APPRAISAL

An independent appraiser will inspect the property and provide an opinion of its fair market value.

7. UNDERWRITE

The lender's underwriter will make sure your financial profile matches loan guidelines and criteria.

8. REVIEW CLOSING DISCLOSURES

Lenders are required by law to provide you at least 7 days to review your closing disclosures.

9. CLOSE AND RECORD MORTGAGE

You become the rightful owner of your home!

WHAT IS AN APPRAISAL?

Before approving your loan, a mortgage lender will require an appraisal of your property, which is a report that sets forth an opinion or estimate of the fair market value of the property. Lenders use the report to determine how much they are willing to lend against the property.

WHY IS AN APPRAISAL COMPLETED?

For purchase transactions, the appraisal is prepared to make sure that the property's market value meets or exceeds the price you have agreed to pay in a purchase contract.

For refinance transactions, the appraisal report makes sure that the property's market value exceeds the mortgage amount for which you are applying.

WHAT IS APPRAISAL PROCESS?

1. The lender orders the appraisal report.
2. The appraiser agrees to the request from the lender.
3. The appraiser contacts the seller's agent (for a purchase) or the homeowner (for a refinance) to schedule a home inspection.
4. The appraiser inspects the house.
5. The appraiser drafts the report.
6. The appraiser submits the report to the lender.
7. The lender is legally obligated to provide the borrower with a copy of the report.

WHAT DOES THE APPRAISER DO WHEN INSPECTING THE HOUSE?

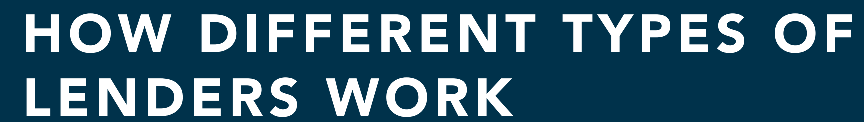
The appraiser completes the following tasks:

- Measures the house and sketches a floor plan
- Takes photos of interior and exterior
- Summarizes general overall condition using visual observations (this is not the same as a home inspection because there is no testing of anything)
- Takes a physical count of all rooms
- Lists all the features (e.g.,fireplace, garage, type of heating, etc.)
- After visiting the property, the appraiser collects the lot size, taxes, zoning, and other land-related data via public records.

HOW DOES THE APPRAISER DETERMINE THE VALUE OF THE HOUSE?

Appraisers research sales in the subject property's neighborhood and select the sales that are most similar to the subject property. The appraiser then makes adjustments to those sales to account for the differences in features and condition as compared to the subject property. Finally, the appraiser factors in additional information regarding market conditions and housing trends. Once all of this is complete, the appraiser is able to render a well-informed opinion of value.

HOW DIFFERENT TYPES OF LENDERS WORK



As a buyer, you have the choice to secure financing from any institution. Ultimately, your home loan is a commodity, so it's important that you are able to distinguish between the various types of lenders.

BANKS AND CREDIT UNIONS

Banks and credit unions (which function like banks, but have a membership requirement) offer the same loan services. Therefore, we will refer to both types of institutions as "banks." Banks can either be federally or state chartered, which determines where they are legally able to lend money. State chartered banks can only lend in states where they have retail branches; federally chartered banks can lend across state lines.

Simply put, banks take deposits from consumers and then use those deposits to lend money to other consumers, effectively matching the demand for capital with supply. The bank's profit is the difference between what the interest they earn on money they lend less the interest they pay to depositors for the privilege of using their money.

When it comes to residential loans, most banks only retain a small portion of the loans they issue to consumers. It's more typical for a bank to use their customers' deposits to fund a loan and then sell the loan in the secondary market shortly after closing. Once the loan is purchased by another institution, the bank returns the cash from the sale to their balance sheet and can use it to fund new loans.

It's important to note that many banks that sell loans in the secondary market retain loan servicing responsibilities (i.e., sending statements, collecting monthly payments, and managing any escrow accounts for taxes and insurance). Doing this allows banks to continue engaging with their customers, and also earns a management/service fee from the institution that purchased the loan. In a case like this, you make your mortgage payment to the bank, but they actually forward it to the institution that owns your loan.

MORTGAGE COMPANIES

Mortgage companies are regulated by each state they do business in and perform a primary lending function to similar to banks. However, because mortgage companies cannot legally take deposits, they rely on borrowed capital to fund their loans. Mortgage companies often maintain a line of credit (called a "warehouse line") with a bank and then use these borrowed funds to lend to consumers. Then, similar to a bank, when a mortgage company sells its loans, the proceeds go toward paying down their warehouse line borrowings, which in turn frees up capital necessary to make new loans.

A mortgage company makes money through both the fee they receive when selling their loans and also from the difference between the interest rate on the loans they make and the rate charged on their warehouse borrowings. Most mortgage companies do not service their loans, so there is a good chance that when a loan is sold, a third party will take over the obligation to collect your monthly payments.

Also, because mortgage companies are required by their warehouse lender to sell the loans within a specific period of time, it's more difficult for them to make loans that don't meet secondary market guidelines. Some mortgage companies maintain relationships with other institutions that can make these "portfolio" type loans, however this is generally a function best left to banks.

MORTGAGE BROKERS

A mortgage broker's role is to work with a customer, gather information to determine their eligibility, and provide a number of potential financing options across multiple lenders. Prior to the most recent financial crisis in 2008, mortgage brokers accounted for almost a third of all U.S. mortgages. However, some unsavory mortgage brokers lost sight of their intended role and placed borrowers in unsuitable loans while collecting dual fees from both consumers and lenders. This practice, which contributed greatly to the financial crisis, has since been outlawed. However, the damage was done, and today mortgage brokers are responsible for approximately 10% of today's mortgage market.
Mortgage brokers do not actually lend money. Like mortgage companies, brokers are regulated at the state level, but they act more like matchmakers – pairing you with lenders who accept loans originated by brokers.

UNDERSTANDING CLOSING COSTS

The purpose of this article is to help you understand the costs associated with closing your home loan. This article covers general information regarding closing costs, including lender credits, which some lenders offer to offset the closing costs. In addition, there is a general overview of discount points and pre-paid charges that will be paid at the time of closing.

CLOSING COSTS

Closing costs are the customary expenses when closing a residential home loan. Typical closing costs include the following:

Appraisal: A third-party fee for having a certified appraiser determine the market value of the property

Origination Fee: A fee charged by the lender for the processing, underwriting, and closing of your loan

Credit Report Fee: A third-party fee for retrieving a credit report

Tax Service Fee: A third-party fee to confirm that the property taxes have been paid on time and that there aren't any tax liens attached to the property

Attorney Fee: A third-party fee for the closing attorney's work related to the loan, which may include preparation of a purchase & sale agreement, title examination, and closing your loan

Title Insurance:

- Lender's Title Insurance – Mandatory insurance that protects the lender in the event a title issue is discovered after the closing. This applies to all purchase and refinance transactions.

- Owner's Title Insurance – Optional insurance that protects the borrower in the event a title issue is discovered after the loan closing. This is typically only necessary for purchase transactions.

Recording Fee: A third-party fee charged by the local registrar of deeds to formally record your mortgage.

DISCOUNT POINTS ("POINTS")

Points are a fee you pay to the lender at closing in exchange for a lower interest rate over the life of the loan. This is referred to as "buying down" the rate.

Each point is equal to 1% of the mortgage amount or $1,000 for every $100,000.

Example:

One point on a $200,000 loan is $2,000. Assuming the interest rate on the loan is 5.125% and each point lowers the interest rate by .25%, paying one point at closing would drop your rate to 4.875%.

Paying points only makes sense if you're planning on staying in the mortgage long enough to realize the savings from a lower interest rate.

Hypothetical Example of How Points Affect Your Interest Rate and Payments (Not including taxes or insurance)

Here is the hypothetical example in greater detail:

	0 POINTS	1 POINT	2 POINTS
COST PER POINT	$0	$2,000	$4,000
INTEREST RATE	5.125%	4.875%	4.625%
MONTHLY PAYMENT	$1,088.97	$1,058.42	$1,043.29
MONTHLY PAYMENT SAVINGS	$0	$30.55	$45.68
BREAK EVEN	N/A	65.4 months	87.5 months
TOTAL SAVINGS OVER THE LIFE OF A 30 YR LOAN	$0	$9,000.70	$12,444.54

LENDER CREDITS

A lender credit or "closing cost credit" is a credit the lender provides to offset some or all of the closing costs. While a lender credit reduces out-of-pocket expenses at closing, it means you'll have a higher interest because the lender will roll the credit into the interest rate. (Nothing is free!)

If a lender issues a lender credit to cover all of the closing costs referenced above (excluding owner's title insurance, which is always paid by the borrower), the loan is referred to as a "no cost" loan.

PREPAID CHARGES

Prepaid charges are expenses that you pay at closing before they are technically due. Since mortgage payments are made in arrears, interest through the end of the month is always included as a prepaid item. In addition, if you are escrowing taxes and insurance, the lender is required to either create an escrow account or adjust the seller's existing escrow account. In addition to interest, prepaid charges may include taxes, hazard insurance, private mortgage insurance (PMI), or other special assessments.

LOAN CLOSING COSTS

FEE	DESCRIPTION	APPROXIMATE COST
Appraisal Fee	Independent assessment of property value	$350 - $600
Origination Fee	Lender fee for processing and underwriting your loan	$200 - $1200
Credit Report Fee	Credit report from the three Credit Bureaus	$25 - $70
Attorney Fee	Fee for attorney's work to close your loan	$700 – $1100
Title Insurance	Insurance against defects or liens on property	$2.50 per $1,000 of loan amount
Recording Fee	Fee to record eeed and mortgage at county registry	~$350
Miscellaneous Fees	Tax Service, Flood Certification, Municipal Lien Cert	~$200

Expected Closing Costs on a $500,000 loan = $3,500 - $4,200

WHAT HAPPENS AFTER YOU CLOSE?

Your obligation as a borrower begins immediately after you close your loan. From that point forward, you are expected to make your loan payments each month. Often, the institution that closed your loan is not the institution that will service your loan (most loans are sold in the secondary market after closing). Your loan servicer may be a financing company or it can be a company specifically designed to service your loan. In either case, most servicers offer user-friendly technology to safely make your loan payments.

COMPONENTS OF YOUR MONTHLY MORTGAGE PAYMENT:

Principal and Interest (P&I):

P&I are the main components of your monthly mortgage payment. Principal is the amount borrowed that has to be paid back to the lender. Interest is what the lender charges for lending you the money.

Real Estate or Property Tax:

Real Estate (aka Property Tax) is a tax assessed on real estate. The tax is based on the value of the subject property and is assessed by your local municipality.

Homeowner's Insurance:

Homeowner's insurance is available for owner-occupied properties and protects against personal liability and physical property damages for a dwelling and its contents.

Mortgage Insurance:

If your down payment on a one-unit primary residence is less than 20%, your lender will require that you secure mortgage insurance. This insurance protects the lender in the event of a loan default, but the monthly premiums are paid by the borrower. There are scenarios in which the lender will pay the mortgage insurance premium on behalf of the borrower, but this will result in a higher interest rate on the loan.

Flood Insurance:

Flood insurance compensates for physical property damages resulting from flooding. It is required in federally designated Special Flood Hazard Areas. Lenders conduct a flood certification during underwriting to determine whether the subject property is in a designated flood zone

HOMEOWNERS ASSOCIATION (HOA) DUES:

An HOA is an entity formed to manage the day-to-day operation and long-term interests of residential dwelling communities, including condominiums, townhomes, and co-ops. The HOA is typically created and vested with specific roles, responsibilities, and rights by the project's legal documents in compliance with applicable laws.

HOA dues are the monthly fees that the owners of individual units must pay to the owners of the property in order to fund maintenance and improvements.

4 WAYS TO MAKE LOAN PAYMENTS:

Online banking – Using your loan servicer's website, you enter the amount you owe and submit your payment each month.

Automated – You authorize your loan servicer to make automatic withdrawals from your bank each month.

By Phone – You call your loan servicer and enter mortgage payment information into a voice-based processing system.

By Mail – You mail a check to mortgage loan servicer.

WHY YOUR MORTGAGE WAS SOLD AND WHAT THAT MEANS FOR YOU

The mortgage market consists of two sub-markets, the primary (or retail) market and the secondary market. When you apply for a mortgage with a lender, you're operating in the primary market.

The secondary market is where retail lenders (e.g., banks and mortgage companies) sell their closed loans to investors. These investors either retain the loans (adding them as assets on their balance sheets), or bundle them with other closed loans and sell them in pools to an agency (e.g., Fannie Mae or Freddie Mac) or to institutional investors such as pension funds or endowments.

The most important thing for you to know is that the lender purchasing your loan cannot change its terms. Your rate and monthly payment will remain the same. The only thing that will change is the address to which you send your payments.

WHY LENDERS SELL LOANS

Let's start with the simplest scenario. Loans from a mortgage companies such as Quicken Loans or pretty much any other company with "mortgage" in its name do not have depositors (like a bank), so they must temporarily finance their loans with a line of credit called a warehouse line. Banks provide these lines of credit, most of which include provisions for loans to be sold within 30 days of closing.

Banks, on the other hand, have balance sheets and access to deposits which they use to finance loans. This means the bank can either keep your loan on its balance sheet or sell it. This decision is based on numerous factors including a sophisticated cost/benefit analysis of keeping vs. selling the loan. This analysis may take into account factors including the interest rate the bank will receive from you, the origination costs for the loan, the price the bank can garner in the secondary market, how quickly the bank thinks you'll pay the loan back, and how much the bank must pay its depositors. There are also more qualitative factors that come into play such as how much exposure a bank wants on its balance sheet to residential loans and if they have a department dedicated to servicing loans.

HOW YOU CAN END UP WITH TWO LENDERS

One interesting wrinkle in who owns your loan is that your lender can sell your loan, but retain loan servicing responsibilities. "Servicing" includes the ongoing management of a loan's billing, payment collection, and escrow account management. This scenario applies most often when a bank chooses to sell a loan to Fannie Mae or Freddie Mac. While these agencies purchase loans from lenders, they do not have the capability to provide consumer services.

This feature is especially valuable to local banks because the sale of the loan replenishes their capital (so they can make new loans), and maintaining service activities allows them to continue building their customer relationships. Banks sell loans with "servicing retained" receive a smaller upfront fee from the purchasing agency, but also receive ongoing payments for servicing the loan.

As for how this type of arrangement affects you, if your loan is sold to Fannie Mae or Freddie Mac, you may not even realize it since the bank that originated the loan will still be your primary contact.

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