

## **Financing Options for Your Home**

Finding the right home can be a difficult decision, one that takes significant reflection and research. What area of town do you want to be in? Is it in the school district you want? What amenities are your “must haves”? Does it have the number of bedrooms you desire? What’s the neighborhood like?

Choosing the perfect home for you and your family can be one of the biggest decisions you make over your lifetime. An equally significant decision is how you pay for it. Before you jump at the first mortgage loan you’re offered, make sure to review the variety of options available to you.

First, the basics: a mortgage is a long-term loan that uses real estate as collateral and is used to purchase a home. Sometimes, a home can serve as collateral for more than one mortgage. When this is the case, the second mortgage, often called a home equity loan, is used to finance a home improvement project or other major purchase. Mortgages most often are described by their terms, such as the time frame for repayment and whether the interest rate is fixed or adjustable.

A potential home buyer who wants to be as ready as possible should consider checking their credit through one of the credit reporting services that offer one free report per year. The Federal Trade Commission offers the only authorized source to obtain your free report under federal law at [www.ftc.gov/freereports](http://www.ftc.gov/freereports). Credit records often contain mistakes and it would be best to clear these from your record before you apply for a loan. Also, while lenders’ credit requirements have tightened considerably, don’t abandon the hope of buying a home if your record shows a few blemishes. Some lenders still offer loan programs that can accommodate borrowers with less than perfect credit. It would also be a good idea to gather the records you’ll need for a mortgage application, such as earnings statements and rent receipts, before going to the builder’s model home.

Here are some of the most common mortgage options on the market today:

### **Fixed-Rate Mortgages**

With a 30-year fixed-rate mortgage, the buyer pays off the principal and interest on the loan in 360 equal monthly payments. The monthly payment for principal and interest remains the same during the entire loan period.

The 15-year fixed-rate mortgage is paid off in 180 equal monthly payments over a 15-year period. A 15-year mortgage typically requires larger monthly payments than a 30-year loan and allows an individual to pay off a mortgage in half the time as well as substantially save on interest payments.

### **Hybrid Adjustable Rate Mortgages (ARMs) and Other ARM Choices**

With a fixed-rate mortgage, the interest rate stays the same during the life of the loan. But with an ARM, the interest rate changes periodically, usually in relation to a specific index such as the national average mortgage rate or the Treasury Bill rate.

Hybrid ARMs have become increasingly popular among home buyers as an alternative to fixed-rate and straight ARM loans. A hybrid ARM has an initial fixed-rate period of five, seven or 10 years, after which the loan becomes an ARM with annual adjustments. The initial interest rates for hybrid ARMs are generally lower than 30-year fixed-rate loans, but higher than one or three year ARMs.

Lenders generally charge lower initial interest rates for ARMs than for fixed-rate loans. This makes the ARM easier on your pocketbook at first; it also means that you might qualify for a larger loan because lenders sometimes make this decision on the basis of your current income and the first year's payments.

Against these advantages, you have to weigh the risk that an increase in interest rates would lead to higher monthly payments in the future. It's a trade-off: you get a lower rate with an ARM in exchange for assuming more risk.

### **Conventional Mortgages**

A conventional mortgage is a loan that is not insured or subsidized by the government. Lenders typically require a downpayment of at least 20 percent on a conventional loan, although you can get a loan with a downpayment as low as five percent if you are willing to pay private mortgage insurance (PMI). PMI protects the lender if the home owner defaults on the loan.

Conventional mortgage loans are typically fully amortizing, meaning that the regular principal and interest payment will pay off the loan in the number of payments stipulated on the note. Most conventional mortgages have time frames of 15-to-30 years and may be either fixed-rate or adjustable. While most mortgages require monthly payments of principal and interest, some lenders also offer interest only and bi-weekly payment options.

### **FHA-Insured Mortgages**

The Federal Housing Administration (FHA) operates several low-downpayment mortgage insurance programs that buyers can use to purchase a home with a minimum downpayment of 3.5 percent. The most frequently used FHA program is the 203(b) program, which provides for low- downpayment mortgages on one- to four-family residences.

FHA-insured loans are available from most of the same lenders who offer conventional loans. Your lender can provide more details about FHA-insured mortgages and the maximum loan amount in your area.

### **VA-Guaranteed Mortgages**

If you are a veteran, active duty military personnel or in the reserves, you may be able to obtain a loan guaranteed by the Department of Veterans Affairs (VA). VA-guaranteed loans require no downpayment, but may require the borrower to pay a funding fee.

### **Rural Housing Service (RHS) Guaranteed and Direct Loans**

The Rural Housing Service, which is part of the U.S. Department of Agriculture (USDA), offers guaranteed loans to moderate and low-income home buyers who live in rural areas. RHS guaranteed loans are offered through approved lenders, while the direct loans are available through USDA's network of state Rural Development offices.

### **State Housing Finance Agencies**

These state agencies often offer loans with favorable terms to first-time home buyers. Local lenders usually know if housing finance agency funds are available for these programs, or you may contact your state housing finance agency directly.

### **Where Do I Go From Here?**

Based on their vast experience, your local home builders help home buyers find lenders who can help navigate the confusing financing process.