



# Shopping For a New or Reduced-term Mortgage

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Houses have been sold on the installment plan since the days of Julius Caesar.

Since most of us do not have enough cash for what is usually a family's largest single purchase, we need to secure a loan from a bank, savings and loan or credit union. By knowing what to look for and shopping around, you can save thousands of dollars in closing costs and interest payments during the life of your housing loan or mortgage.

## The Mortgage

A mortgage is a legal instrument that gives the lender conditional title to the property. Mortgage loans allow a lender to sell the borrowed property to pay off the remaining debt if the borrower fails to repay the loan.

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## Know Yourself

First, you need to know yourself, your housing needs and your financial limits.

Be sure you want to buy. Consult NDSU Extension Service publication FE-241, "To Buy or Rent? The Choice" if you are not certain. You'll need to know how much of a down payment you have available and how much of a monthly payment you can afford. These things will determine your price range for affordable housing.

## How big a mortgage can you afford?

The mortgage that's right for you depends on several variables: how much money you need to borrow, your stage in life, how long you will be in the house, what your budget will allow, what your housing priorities are, whether you like to take risks, and how much you are willing to pay (in cash) for all the fees, assessments, processing charges and up-front interest costs when you sit down at the closing table to sign the papers.

One rule of thumb states that your house payment, with taxes and insurance, should not exceed 25 percent to 28 percent of your gross monthly income (or income before taxes and other deductions),

and that all debt should not exceed 36 percent of gross monthly income. These percentages may vary with guidelines established by various banks and the federal government (for federally insured loans). Consult the following graph to determine your affordable mortgage.

## Choose Your Lender

Find a lender you are comfortable with, who will help you get through the process as smoothly as possible and will help you get the best possible deal for the best possible price. You can check the yellow pages in your phone book for credit unions, savings and loans and full-service banks that make mortgage loans. Usually the best options are for a friend, relative or colleague who has had a good experience, or a real estate agent, to refer you to a lender.

Shop around a bit. Interest rates will vary by only a fraction of a percentage point from lender to lender, and the closing costs and points can and do vary.

You will want to do business with loan officers who offer information and assistance rather than high pressure, who are responsive to your needs and who ask you questions to learn all they can about your individual situation.

## How much house?

Gross Annual Income	Gross Monthly Income	Maximum House Payment	Total Monthly Payments (all bills)	Approximate Affordable Mortgage**
		25%-28%*	36%	
\$12,000	\$1,000	\$250-280	\$360	\$27,000
\$18,000	\$1,500	\$375-420	\$540	\$47,000
\$24,000	\$2,000	\$500-560	\$720	\$65,000
\$30,000	\$2,500	\$625-700	\$900	\$82,000
\$36,000	\$3,000	\$750-840	\$1,080	\$97,000
\$48,000	\$4,000	\$1,000-1,180	\$1,440	\$130,000
\$60,000	\$5,000	\$1,250-1,400	\$1,800	\$160,000
\$80,000	\$6,666	\$1,666-1,866	\$2,400	\$220,000

\* Per month, includes insurance and taxes.

\*\* This is the approximate amount of the 30-year mortgage loan at 9 percent interest, with average real estate taxes and insurance that will demand a house payment within the guidelines.

Look for experience, competence and straightforwardness. Avoid anyone who suggests you needn't "worry" yourself about the process and suggests you "just sign, it's all standard procedure."

### Your responsibilities

If you are given brochures to read, read them and write down any questions you might have. Make sure you ask questions until you get an answer that satisfies you.

When you have decided to apply for a loan with a particular lender, be certain to completely fill out all the forms you receive.

Play close attention to the disclosure notice concerning closing costs. (A detailed explanation of closing costs is included in the Costs section of this publication.) When you close the loan, make sure your closing costs are the same as, or similar to, the estimates you received when you first inquired about the loan.

Try to be responsive to calls from your loan officer or anyone else involved in the process. Be somewhat flexible in helping them schedule a closing meeting.

Read before you sign. Be sure your decisions reflect what you know is right for you.

## Types of Mortgages

A variety of mortgage loans generally are available. A real estate agent or lender can help match you to the right source.

### Conventional

Conventional loans are available for up to 90 percent of home value. Mortgage insurance is required for loans exceeding 80 percent of the home's value. Loans are not assumable. An assumable loan is one that the home's next buyer can take over, with enough down payment.

### Farmers Home Administration

Insured by the government, FHA loans are available up to 95 percent of the home's value, although some smaller loans may allow even smaller down payment.

Mortgage insurance is required and the loan may be assumable by the next buyer.

The most you can borrow is roughly enough to finance a medium-priced home in your county.

### Veterans Affairs

VA loans are available to members of the armed forces, veterans and their spouses. Loans are up to 100 percent of the home's value. The

home must be the primary residence. Loans may be assumable. The veterans must have served 180 days in peacetime or 90 days in wartime, including the recent Gulf War.

### Energy-efficient Mortgage

While the typical mortgage is based on a debt-to-income ratio of 28 percent gross income for housing, and no more than 36 percent for all debts, the Energy-

efficient Mortgage is a special type of mortgage that takes into account the monthly operating cost savings realized by living in an energy-efficient home.

Maximum monthly mortgage payments can be raised from 28 percent to 30 percent of the buyer's adjusted gross income. Your lender should have the proper forms to apply for an EEM.

## Terms of the Loan

Loans also can vary by the different terms or conditions of the loan.

### Interest rate "lock-in"

You may wish to obtain a mortgage lock-in if you expect interest rates to rise between the time you apply for the loan and your actual closing date. The lock-in is a lender's promise to hold a certain interest rate (and possible points) for a specified period of time. Often you are charged for the lock-in or an extension of a traditional lock-in.

### Length of loan

The term is the life or length of the loan, usually 15 to 30 years. Fifteen-year and 20-year loans are becoming increasingly common and are popular for refinanced loans. While payments are higher, interest rates usually are lower and you save much money in interest costs.

The most common choice is the 30-year mortgage, although the average American moves every nine years.

## Added principal payment

The added principal payment is not really an interest rate option, but a recommended strategy for you to pay your loan off early and save interest charges. Your lender may allow you to make additional payments toward the principal of your loan on a monthly or other basis. This results in paying off the principal early, thus saving much in interest costs.

## Types of Interest Rate Options

### Fixed rate (standard)

The interest rate and payment (not including taxes and insurance) stay the same throughout the life of the loan. This type is a good choice for people who like a predictable budget.

### Adjustable-rate mortgage

The interest and payment are adjusted at predetermined, one- to three-year intervals, according to a set formula that is tied to current economic indicators, such as Treasury bills. Increases should be subject to a limit or cap. Look for ARMs with no more than a 2 percentage point annual cap and a 6 percent overall cap for the life of your loan. A cap is the limit on the rise or fall in the interest rate. An ARM may be a good choice for people who plan to move in a few years or who like to take risks.

### Balloons

Balloon loans offer a lower fixed interest rate for a set number of years (usually three to seven), followed by a longer term mortgage. At the end of the balloon loan, the balance is due so you must refinance. This type of loan may be good for people moving soon or expecting a windfall.

### Biweekly payment

The loan is set up like a conventional mortgage, but you make payments every two weeks, or 26 times a year. This can reduce the term of your mortgage and save you interest

because you make the equivalent of 13 monthly payments each year.

## Costs

Mortgage lenders are required to give you a good-faith estimate of all closing costs and other charges within three days after you apply for a mortgage.

## Down Payment

The down payment is the hurdle that most often trips up first-time home buyers.

Conventional mortgages generally require 20 percent down, or 10 percent down and mortgage insurance. Less is required of government-insured mortgages, such as FHA and VA.

## Points

One point equals 1 percent of the mortgage amount and usually is paid to the lender at closing as interest in advance. You usually can get a lower interest rate on your monthly mortgage payment if you pay some of these interest costs up front. If you plan to stay in the home for several years, paying an extra point or two to get a lower interest rate often is worth the effort. Your lender can help you determine the break-even point on the loan. Points may range from a fraction of a point to 5 or 6 and are negotiated between the lender and the buyer.

## Closing Costs

Closing costs include the application fee, points, appraisals, title insurance and origination fees, as well as additional processing charges. These generally run from 2 percent to 4 percent of your loan amount (\$1,000 to \$2,000 on a \$50,000 mortgage). Sometimes (especially on a refinanced loan and sometimes on an FHA loan) you can include at least part of your closing cost in your loan amount.

## The Payment

The payment usually is made once a month and includes both principal and interest, as well as an additional amount to cover real estate taxes and homeowners insurance, and any special assessments on the property. Amortization is a home mortgage payment plan that allows the borrower to reduce the debt gradually through equal monthly payments that are part principal and part interest.

## Refinancing Tips

People who bought homes in the late 1970s and 1980s are clamoring to refinance their home loans at today's lower interest rates. Reduced interest rates mean long-term savings on finance charges and extra household cash each month. Many home owners are opting for a reduced-term loan to further cut finance charges. Bankers report that more than half of all new mortgages are being written to replace existing ones.

While any interest rate drop will lower your payments, the closing costs associated with refinancing your home loan can delay your financial gratification for several years, or even make refinancing a losing proposition.

Your banker may be able to do a "break even" calculation to illustrate how long you will need to stay in your home to recoup your closing costs and points.

Other factors affecting the refinancing decision include the specific terms of the loan, the length of the loan and anticipated future inflation rate.

For example, 10 years ago you borrowed \$70,000 to buy a home. The interest rate was 9 percent and your payments, not including taxes and insurance, are \$563 per month. You are considering refinancing and find that you have paid \$7,400 on the loan. You find you can refinance a new mortgage of \$62,600 for 20 years at 8 percent. Your payments would be

## Monthly principal and interest payment per \$1,000 borrowed.

Mortgage rate	15-year loan	20-year loan	25-year loan	30-year loan
5.00	7.91	6.60	5.85	5.37
5.50	8.17	6.88	6.14	5.68
6.00	8.44	7.16	6.44	6.00
6.50	8.71	7.46	6.75	6.32
7.00	8.99	7.76	7.07	6.66
7.50	9.28	8.06	7.39	7.00
8.00	9.56	8.37	7.72	7.34
8.50	9.85	8.68	8.06	7.69
9.00	10.15	9.00	8.40	8.05
9.50	10.45	9.33	8.74	8.41
10.00	10.75	9.66	9.09	8.78

\$523 a month, with the net savings due to refinancing of \$40 per month.

If your refinancing charges are \$2,000, you would need 50 months, or four years and two months, to break even – not accounting for inflation. At 5 percent inflation, your break-even point would be four years and eight months. You would need to plan to be in your home at least that length of time for the refinancing to be profitable.

Using the chart below, you can determine (for instance) that the payment on a \$60,000 mortgage at 8 percent interest for 25 years would be \$463.20 per month. (This does not include taxes, insurance and assessments.)

## Loan Application Process

### Qualifying for the loan

Even though you already are living in your home, you and your home will have to pass some credit tests. If your income has dropped or your

other debts have climbed since you took out the original mortgage, you may not be approved for refinancing.

Has your house maintained its market value? The new mortgage, like your present one, cannot exceed 80 percent to 95 percent (depending on the type of mortgage) of the appraised value of your property.

Unless you have extra cash, you will need to refinance at least enough of the old mortgage to pay off the balance. You may even decide to remodel or make improvements at this time, increasing the amount of your mortgage loan.

### The abstract

Make sure you know where your abstract of title is located. The abstract is a sheaf of papers that certifies all the legal recorded documents, including deeds, mortgages and other transactions regarding that property. You may have the abstract on file in a safety deposit box or your insurance company may have it.

## Negotiating

Talk first to your current lender. Some banks are eager to keep their mortgage customers and will give you a break on closing costs. Whoever you end up dealing with, discuss trade-offs between closing costs and interest rates. For an extra fraction of a point on the rate, they may pick up part or all of the closing costs.

## When It's All Said and Done

Tough to believe, but when the process of obtaining or refinancing a home loan is over, you'll probably forget most of the details. You'll be enjoying the new house, a lower mortgage payment or perhaps the satisfaction of knowing you are saving a lot of money in interest charges.

## Suggested References

- North Dakota Agencies:
  - State Insurance Commissioner, (800) 247-0560
  - Attorney General's Office, Consumer Fraud and Antitrust Division, (800) 472-2600
- Your local board of real estate agents
- Your local banker or other financial professional
- Buying a Home (The First Time Around) University of Wisconsin-Extension. Publication B3426. Available from: Agricultural Bulletin, Room 245, 30 Murray St. N., Madison, WI 53715

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