Mortgage Basics

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1. Is it Better to Rent or Buy a Home?

Often the first decision a person ponders when considering owning a home is whether it's best to rent or buy a place to live. While it's impossible to give a blanket statement on which is better, it is possible to give an outline of circumstances that may make one or the other more favorable for your situation.

Renting vs. Buying – An Emotional & Financial Decision

"The American Dream" often includes the notion of homeownership. For many, the prospect of owning a home has been a dream since an early age. For this reason, it's not simply a financial decision when debating renting versus buying a house, condominium, or another type of property, but an emotional one as well.

Financial Considerations

If you were to look at a home as strictly a financial decision, then the math rarely points to purchasing as a better option in the short term. The stock market regularly outperforms returns on homes, and the fees involved usually make owning a more expensive option than renting.

Real Estate Fees

The main problem with purchasing a home is the combination of cash required for the down payment; real estate transaction, lending, and other fees incurred; as well as the mechanism by which a mortgage amortizes over time. For the most part, homebuyers have sizable closing costs and other expenses to consider. One-time transaction fees and ongoing service fee requirements that do not exist in a typical rental.

Many of these costs, if spread across a lifetime, could make the financial decision sway in favor of ownership. However, many Americans will own their home for just a few years. For this reason, these expenses are not spread across the typical 30-year timeframe and make the cost of owning the home, and later selling the home, much higher.

Building Equity in Your Home

The argument commonly forged relating to gaining equity in a property usually only happens after paying on a mortgage loan for several years. The way mortgages amortize, or are paid over time, is structured so that in the beginning much of the payment only goes toward the interest on the loan, as opposed to paying down the principal.

This creates a situation whereby the principal balance of the loan is very close to what it was to begin with even after five or six years of making regular mortgage payments.

Combined with the selling and moving costs, the buyer, who is now the seller, is often left in a situation where they will lose a considerable amount of money from the transactions because they have very little equity stake to make up the difference.

With all that said, property values are currently on the rise due to short supply in many major cities, along with other factors, so this is a period where the opposite is true for many who bought just a few years ago. However, buying now while prices are high could put you in a situation where you have to short sale the property if prices fall again like they cyclically do.

Here are several advantages and disadvantages to consider with owning a home.

Pros of Buying a Home

- Build equity in land, structure, or both, by paying down the loan
- Profit from increased home prices
- Receive tax deductions for the interest portion of the mortgage payments, real estate taxes, and insurance
- Only minor fluctuations in payment amount (if fixed-rate mortgage)
- It feels good to own
- More control over the property and land

Cons of Buying a Home

- High upfront costs
- Total responsibility for repairs
- Home could lose considerable value
- Meant to be a long-term investment – buyer likely to lose money if sells too soon

How Much Can You Afford?

When lenders look at the credentials of a potential borrower, one of the main factors they look at is capacity – the borrower's ability to repay the loan. A key metric used to determine this is their debt-to-income ratio.

Debt-to-Income Ratio

In this ratio, the lender determines how much of the borrower's pretax monthly income would go toward the mortgage payment. Usually, banks like to cap the total percentage of income spent on all housing related expenses (mortgage payment, insurance, real estate taxes) to 28%, and all debt to 36%. Often referred to as the 28/36 rule.

For instance, if your monthly income was $5,000, the bank would be most comfortable with housing expenses up to $1,400 (5,000 * 0.28), and total debt expenses up to $1,800 (5,000 * 0.36) per month.

Final Thoughts on Renting Versus Buying

Overall, the decision to buy or rent a home cannot be answered simply one way or another. Each person's situation is unique. One of the most important pieces to keep in mind is the length of time you plan to stay at your new residence.

2. What are the Common Types of Home Mortgage Loans?

Once you have decided in favor of buying a home rather than renting one, the next choice you must make is where to obtain the mortgage loan and the type of mortgage best suited for your situation. With the ever-increasing complexity and variety in mortgage options, it is easy to be overwhelmed.

The following should provide a brief overview of the most common types of home mortgage loans and how each of them works over the long run.

4 Common Types of Mortgage Loans

1. Fixed-Rate Mortgage Loan

Historically, fixed-rate mortgages are the most common types of home loans issued, with nearly 90% of homebuyers choosing a fixed-rate loan. The term for these mortgages typically runs 30 years, with 10, 15, and 20-year term lengths as well. Fixed-rate mortgages offer consistent monthly payments, at a reasonable level, due to their extended repayment period. Consumers are content knowing the payment will be roughly the same year after year regardless of variations in interest rates.

15 Versus 30-Year Fixed-Rate Loans

A decision many homebuyers will ponder when approaching a fixed-rate home mortgage loan is the term length. Should I choose a 15 or 30-yr home loan? The argument is often made to show how much interest will be saved with a 15-year mortgage versus a 30-year loan; however, that should not be the only deciding factor.

Overall, most people prefer the 30-year mortgage option. This is due to the flexibility it provides by way of a lower monthly payment. With a 15-year mortgage, the total interest paid is much less over the length of the loan because the monthly payments are significantly higher. Signing on to this term is forcing the borrower to meet these higher payments each month, and that can be a challenge for some.

On the other hand, if one were to elect the 30-year mortgage, nothing in the agreement is usually stopping them from paying more than their minimum payment each month. This can speed up repayment of the loan as fast as the shorter-term option. Borrowers can make higher payments and reap many of the benefits of a 15-yr mortgage loan without a higher monthly mortgage payment obligation.

The main potential downsides of obtaining a 30-year loan and paying it off faster are that the initial interest rate is typically a little lower on a 15-year mortgage loan and there may be prepayment penalties for paying it off early.

2. Adjustable-Rate Mortgages (ARMs)

The next most popular type of mortgage loan is the adjustable-rate mortgage, often referred to as an ARM. With an ARM, the interest rate and the corresponding monthly payment change in sync with changes in the overall market interest rates. These changes could be tied to various indexes; however, the most common is the current yield on 1-year US Treasury bonds.

ARMs usually begin with a fixed-rate period, where the rate offered is below interest rates on traditional fixed-rate mortgages. This lower rate, often called a teaser rate, can attract many borrowers looking for the lowest monthly payment. After this fixed-rate period expires, the rate adjusts in correlation to current interest rates on a specific index. The most common length of the initial fixed-rate period is 5 years, with rate adjustments coming every 1 year after. This would be described as a 5/1 ARM.

Although the initial interest rate on an ARM may be lower than a conventional fixed-rate loan, there are caveats. If the interest rates rise dramatically, the borrower could be left with loan payments more than double their original amount. This sharp increase is difficult to budget for and has led to many foreclosures in the past.

If you want to pursue an ARM, be fully aware of the possible increases, and be prepared to come up with additional funds each month. Be sure to talk to a qualified mortgage lender to fully discuss the pros and cons of an adjustable-rate mortgage loan.

3. Interest-Only Mortgage Loans

Interest-only mortgage loans, when used for residential lending, are typically bi-products of adjustable-rate home mortgages. Many of the facts of an ARM hold, but during the fixed-rate period, the borrower is only required to pay the interest on the loan. Once this period is up, the rate adjusts to the market rate, and the amortization (pay down) is accelerated to make up for the period of no principal being paid.

Interest-only home mortgage loans, while most common in commercial settings, are sometimes used by high-income individuals with significant variations in their monthly incomes, such as a commission-based real estate salesperson. They can be used in certain scenarios to the borrower's benefit, but most borrowers prefer an ARM or a fixed-rate loan.

4. Subprime Mortgages

Subprime mortgage loans are typically issued to borrowers who have recent or ongoing credit issues. Although each lender's limit varies, many use a credit score of below 670 as the qualifying level at which a loan will be subprime. Using the low credit score of the borrower as an indication of risk to the lender, the rates will be higher on subprime mortgages than the aforementioned options.

While traditional mortgages tend to be very similar in terms and rates across lenders, subprime loans can vary widely depending on the specific credit situation of the borrower in question. For this reason, consumers looking into subprime home mortgage loans for real estate purchases would be even more prudent to attain quotes from various companies as the payments and terms could be drastically different.

Final Thoughts on the Different Types of Home Loans

Generally speaking, a 30-year conventional, FHA, USDA, or VA home mortgage loan is going to be a smart move.

If you only plan on being in your home for a short amount of time, then an ARM or interest-only loan could work for you. Especially if you think the value of the property you're buying will rise quickly. Sub-prime mortgages are for home buyers with lower credit scores that have a solid income and are looking to also achieve the American dream.

3. What are the Common Types of Home Mortgage Lenders?

Just as the variety of mortgage loan options has increased over time, as has the variety of sources for mortgage financing. It's no longer just the neighborhood banks that supply mortgage loans; numerous types of traditional and non-traditional lenders are available to homebuyers.

Regardless of where you go for funding, there are a few questions that any potential borrower should ask a mortgage lender.

Key Questions to Ask a Mortgage Lender

1. What are your fees, and will I need to pay them upfront, or will they be included in the loan?
2. Which of the mortgage options offer the lowest interest rates?
3. Is the interest rate quoted variable (will change) or fixed (will not change)?
4. If the interest rate is variable, when and by how much will it change? What is the highest it can go?
5. Would putting more money down qualify me for additional savings, or a lower interest rate?
6. How many years will it take to pay back the loan?
7. What amount will the monthly payment be?

5 Common Types of Mortgage Lenders

1. Traditional Bank

A local bank is the most traditional lending source for a new home mortgage loan. In this situation, the bank will review your credit score and other financial details, including income and employment history, then make the decision whether to lend you money.

Although in the past this type of loan would then stay at the bank where you applied, these mortgages are now most often sold to the secondary market or sold off to larger institutions, which then pool many mortgages together for use in other financial instruments.

2. Mortgage Broker

A mortgage broker is a person or business who, in theory, will use their vast knowledge of various lenders to match your financial circumstances with the best possible option. The mortgage broker will not usually hold on to your mortgage loan or lend any money. They act merely as the middleman between you and the ultimate loan originator, and all of the shopping around for the best interest rates and fees, so you don’t have to.

3. Internet Lender

An Internet lender, much as the name implies, is a firm that mostly uses the Internet to reach a large demographic of people not in their confined geographical area. These online lenders either loan money directly or shop around for the best rate and match you with the best option in their network, much like a mortgage broker. This is typically done through automated computer systems on the back end after you submit your application online.

Given the lenders are from across the country (or globe), the annual percentage rates (APR) offered can be more competitive. However, a downside is the lack of personal interaction, which, in times of confusion or distress, there is no primary person to go and have a face-to-face conversation with.

4. Credit Union

A credit union is a nonprofit financial cooperative, with membership aimed at providing low-interest rate loans to its members. The main difference between a credit union and a traditional bank is that credit unions often hold home mortgages in their own portfolio, as opposed to selling them to the secondary market. For this reason, the credit unions do not need to cater their mortgages or underwriting standards to the larger banks and can often lend at times other banks cannot.

If a traditional bank cannot sell the mortgage to the secondary market, it will often not lend to a borrower regardless of the quality of the applicant or property. The credit union, not having to worry about the later sale of their mortgages, can continue to lend, and are not reliant on a larger institution for their real estate transactions.

5. Home Builder

Oftentimes, the home builders will provide financing to attract homebuyers to their properties. These builders typically have a mortgage subsidiary whose goal is to provide financing to the buyers of their homes. These mortgages are often attractive to home buyers who cannot obtain more traditional financing, as the builders are then the deciding factor in the loan and may be able to offer special incentives to get the homebuyer approved.

Sometimes even borrowers who would qualify for traditional financing will be drawn in by a lower rate or added incentives to secure financing with the home builder. One must be careful, however, as some of these types of loans from custom home builders have been in the news recently for fraudulent real estate lending practices and schemes.

Final Thoughts on The Popular Types of Mortgage Lenders

As with any lending institution, be sure to fully review all the details of the mortgage loan offers or hire a professional to review them for you. Each type of home mortgage lender comes with its own pros and cons, and one may be more beneficial than another depending on a borrower's particular financial situation and needs.

4. Your Credit Score and How Mortgage Interest Rates are Set

After deciding on the best type of mortgage loan for your financial situation and choosing a lender to service that loan, it is necessary to understand what factors will influence your monthly mortgage payment, and what you can do to ensure you reach the best payment structure for your new home.

Credit Score

The rate for a home mortgage or commercial real estate loan is based on the risk you present to the lender. One way mortgage lenders measure this risk is by evaluating the credit profile of the borrower. To analyze this, a local bank, credit union, or another mortgage lender, will pull your credit report and score to take a close look at your credit file which represents your creditworthiness.

These aspects of your financial life provide some insight into your previous borrowing behavior – both the good and the bad. Some of the major factors the lender will take into consideration are as follows:

1. Length of Credit History

Your credit score will show how long you have maintained each of your sources of credit. That can include a student loan, other mortgages, auto loans, credit cards, equity lines, and other types of short and long-term credit. As a general rule, the longer your credit history, the more favorable it looks to the lender.

2. Past Delinquencies

Most lenders tend to predict future behavior from what they can observe from the past, which in this circumstance is the number of late or delinquent payments on

your credit report. The lender also considers when these delinquent payments occurred.

The more recent these appear, the worse for you as the borrower. Recent issues with paying your debts on time will severely affect your credit score and can negatively affect the interest rate and the repayment terms of the mortgage loan you are applying for.

3. Credit Usage

Once the lender knows the amount of credit you have at your disposal, they will then evaluate how much of that credit you are using. This is known as your credit utilization ratio. The closer you are to maxing out revolving credit lines (e.g., a credit card or home equity line of credit), the riskier you will appear to the lender.

4. Credit Mix

Your mixture of credit (revolving credit, installment loans, and a few less-popular types of credit) is also taken into account by the mortgage lender. If the mixture represents a blend of different credit account types, it is often viewed as less risky. It’s generally a good idea to have a variety of account types rather than just a bunch of credit cards, loans, or otherwise.

Evaluating Your Credit

Overall, the higher your credit score, the better your terms will be from the lender. Each borrower will fall into a particular range and that range will help the mortgage lender determine the risk of lending you money. The higher the range the less risky you appear, the lower the credit score range the risker your look to them.

Before applying, it is important to know for yourself what exactly is on your credit report, as there are sometimes errors that could end up costing you in terms of your interest rate, and in turn, a ton of cold hard cash over the long run.

Once you obtain your credit report, it is important to do a few things:

- Review the entire report for errors
- Check for items you don’t recognize
- Take note of delinquent or late payments
- Remedy outstanding balances
- Ensure the accounts shown are yours
- Dispute details that aren’t accurate

How Mortgage Interest Rates are Set

A second important point many borrowers should know is how the interest rates advertised by mortgage lenders are set. For the most part, the rates are not set by the individual lenders, but by the secondary markets – the institutions buying the mortgages made by these lenders.

Rates are primarily determined relative to the current risk-free rate. Typically, the 90-day US Treasury bill is used for this benchmark. From here, the banks add premiums to this rate to compensate for additional risks, as a mortgage loan is not ‘risk-free.” These additional risks include an inflation premium, a default risk, a liquidity premium, and a maturity premium.

So, adding all these risks to the current 90-day US Treasury rate, the bank gets a ballpark idea of the rate they will charge for each type of loan,
e.g., conventional, FHA, VA, USDA, ARM, 15-year, 30-yr, etc.

5. Home Loan Down Payment, Points, Mortgage Insurance, and Other Closing Costs

Another issue to explore before applying for a home loan is which factors influence your upfront costs and monthly mortgage payments. This includes the down payment, mortgage insurance, and points. It is crucial to understand how all of these financial components work before deciding on a home loan.

What is Your Down Payment?

Your down payment will ultimately influence the interest rate offered by the mortgage lender, as well as your ongoing monthly payments.

Down Payment Requirements

In the past, the standard down payment was 20% of the home's purchase price. This in turn would mean the lender was providing 80% of the purchase price as a loan, a level most felt comfortable at. Most lenders reasoned that if they have to take the house back, they should be able to sell it for at least 80% of what the borrower purchased it for and recoup their investment.

However, in recent years the down payment requirement had come down significantly. It was not unheard of in peak times (2006 – 2007) that lenders would even go up to no-money-down mortgages. However, since the housing collapse and subprime crisis, some lenders are back to requiring down payments in the 10 to 20% range.

Currently, without a special incentive program offered by a specific bank, credit union, or other mortgage lender, FHA loans typically require a 3.5% minimum down payment and conventional loans require a minimum of 3% down for people

with an ideal credit history and score. USDA and VA home loans don't typically require a down payment.

Paying the Minimum Down is Not Always Best for Everyone

An important point to keep in mind is that just because a lender only requires three percent down, it does not automatically make that the best option for you. Oftentimes a lender is willing to overlook a low credit score or offer a more favorable interest rate if the more the borrower is willing to put more money down.

Even a small change in the rate offered can have a substantial impact over the life of the loan, so it is important to pursue all options offered by the mortgage lender. Discuss the outcomes of bringing a higher down payment to the table and buying down the interest rate.

Mortgage Insurance

If you do decide to put less than 20% down when purchasing the property using a conventional loan the lender will require a guarantee that they can recoup their investment in the event of a default. This guarantee will come in the form of mortgage insurance, often referred to as private mortgage insurance or PMI. With PMI, the borrower is required to pay a premium each month or cover the entire premium upfront, to help protect the lender against default.

In the case where the borrower is unable to pay the mortgage, PMI ensures the lender will still be paid in full. Most often, this premium is included in the monthly payment the borrower makes and it is arranged by the lender at the time a mortgage is approved.

Consider Paying More Down to Alleviate the Insurance Cost

Private mortgage insurance can increase your monthly payment by a few hundred dollars depending on the amount borrowed. This expense does not benefit you as the borrower in any way long-term, but it does allow you to get a home loan without an even more significant initial out-of-pocket expense.

However, this cost remains with you and your mortgage for an extended period of time, depending on your particular financial situation. The upfront cost savings it allows may not be worth it in the end. For this reason, it is crucial to evaluate your ability to incur this additional monthly cost when getting a mortgage loan and the long-term effect it will have on the total amount you pay for real estate.

Understanding Mortgage Points

An option often presented by lenders is the concept of points and the various connections between points and interest rates. A point is a fee which equals 1% of the loan amount. For instance, on a $200,000 mortgage, 1 point would be equal to $2,000, and 2 points would be $4,000. Typically, the lender has two variations of points:

Origination Fee

The first, known as an origination fee, is a fee charged by the lender to cover the costs of securing the loan. This fee is usually quoted in terms of points.

Discount Points

The second, known as discount points, is prepaid interest on the loan. The more points the borrower is willing to pay upfront, the lower the annual percentage rate (APR) of their mortgage loan will be allowing them to pay less money on interest over the life of the loan.

Although discount points add upfront costs to the mortgage at closing, the reduction in interest rate can, over the course of the loan, more than make up for this fee.

An important piece to keep in mind when debating whether to buy discount points is that the positive impact of paying upfront points is realized over the course of the loan, and not quickly. For this reason, you must be fairly certain you'll remain in that house for an extended length; otherwise, points may not prove financially beneficial for you.

6. What to Expect when Applying for a Home Mortgage Loan

So, you've decided on a piece of property and are ready to get approved for the home loan. After you've reviewed your lending options and the factors that go into determining your monthly mortgage payment you'll want to reach out to some banks, credit unions, or other mortgage lenders to get quotes.

Required Documentation for Mortgage Applicants

Before heading in to see your preferred lender to apply for a loan, make sure you are aware of the paperwork that most lenders are going to require for your mortgage application. It can be a lengthy list, especially as mortgage lenders tighten borrower eligibility guidelines, so take the time to understand what you will need to have ready:

1. Tax returns and W2
2. Name and address of employer or offer letter for employment
3. Social security card or number
4. List of all current creditors and such (credit cards, student loans, child support, car loan, etc.)
5. Investment accounts including 401(k)s, IRAs, cryptocurrency, and brokerage accounts
6. Home sales contract if you already have the home picked out
7. Government-issued ID card

Lenders may require more or less documentation than this, but as a guideline, be prepared to present all of the above.

Questions Mortgage Lenders Ask

Next, there are questions that are most commonly asked by lenders, and preparing your answers ahead of time could help ease the process. These questions will fall mostly into the following categories:

- Employment and other income
- Outstanding debts
- Assets and cash reserves
- Down payment amount
- Purpose of loan
- Property use
- Property type

The following themes in responses will help ease the lender's concerns, and work in your favor:

- You have a steady income and long-term employment
- You have low debt with no recent major purchases
- The property is to be used as a primary residence (as opposed to investment or vacation properties)
- You have a decent amount of money to use as a down payment

Questions to Ask a Mortgage Lender

In response to the lender's questions, it is important that you ask questions of your own. The answer to each question will allow you to compare potential lenders and decide which lender is best for your particular situation.

Here are a few questions to consider asking each mortgage lender:

1. What types of loans do I qualify for?
2. What will the interest rate on each mortgage be? Will this change and, if so, when and by how much?
3. What origination fees will be charged?
4. What are my options to pay points in return for a rate reduction?
5. What are the total closing costs?
6. Is there a prepayment penalty? If so, before what point, and what is the penalty?
7. What is the required minimum down payment? If I present a higher down payment, will it reduce my interest rate?
8. What additional documents are needed?
9. How long will the approval process take?
10. What are the possible reasons for a delay in an approval decision?

After discussing these items with each lender, it is time to apply for the mortgage loan by filling out the appropriate paperwork. Be confident in your decision after choosing the correct type of loan and best mortgage lender for this piece of real estate. A good combination of the two will allow you to move into your dream home quickly.

7. What Happens After Submitting a Home Mortgage Loan Application

Once the home mortgage loan application has been turned in, many applicants wonder what the lender will do with their application, and if there are any additional steps they should take while waiting for the lender's decision. Here's what typically takes place next in the approval process and a few things you can do to help speed things up.

The Mortgage Loan Underwriting Process

After receiving all the required loan application documents for the purchase of real estate using a home loan, the mortgage lender will begin to review them and assess if the risk associated with a loan is in line with their lending standards. This is a process known as underwriting. The lender will look at what is referred to in the industry as the three Cs of mortgage underwriting: *credit*, *capacity*, and *collateral*.

The Three Cs of Mortgage Underwriting

Credit

Credit plays a major role in a lender's determination of a mortgage applicant's risk. By reviewing the credit report and score of the individual, couple, or business, the lender will make an educated estimate of the probability of being fully repaid on the loan.

Capacity

Next, the lender reviews the applicant's capacity to repay. This is assessed by reviewing the W2 forms or pay stubs, employment history, recent bank statements, as well as current debts and assets of the borrower.

The lender then evaluates the debt obligations the borrower already has and compares that to the proposed monthly mortgage payments in relation to the income the borrower receives. This helps the lender determine what the borrower's debt-to-income ratio is now and what it will be after receiving the loan to feel comfortable they will be able to handle repayment of the loan.

Collateral

The collateral refers to the real estate for which the mortgage is issued, including both the structure and land. The lender looks at the current value of the property, its proposed use, as well as the current trends in the housing market. Then they approximate the value they could receive if they were forced to foreclose on it in the event of a default. This amount is compared to the total amount loaned and is included in the overall risk assessment of the borrower and property to be purchased.

After reviewing the three Cs, the lender will have a good understanding of the applicant and whether the loan is appropriate for it to service, given the risk profile of the borrower and the real estate involved.

Home Inspection

While the lender is underwriting the home mortgage loan, there are things that an applicant can do. The first of which is obtaining a home inspection. A home inspection is included in most purchase and sale agreements and is used to determine the overall structural condition of the home.

An inspector will review the major components of the house, condo, or another type of real estate, including the roof, HVAC system, basement, plumbing, electrical, etc., to look for proper condition and building practices.

The home inspection is best done after agreeing upon the purchase price and other terms, but prior to signing the final documents so that you can ask the seller to pay for major repairs or cancel the agreement if there are major issues that arise.

Typically, an adequate home inspection will run between $300 and $750 and takes a couple of hours to complete. However, a full written report may not be available for a day or two. You and your real estate agent should try to be there during the inspection process so it's easier for the inspector to show and explain things to you if needed.

Mortgage Application Denied?

A fear of many applicants, especially first-time homebuyers, is getting denied a home mortgage loan. Although the possibility is there, the chances of such an event are low if applicants fully understand the qualification requirements before applying, and carefully select a good mortgage lender and loan type for their financial situation.

That being said, if the event does occur, there are steps to take which will help in future circumstances:

1. Find Out Why You Were Denied

The lender is required to inform you of the rationale behind their decision within 30 days of issuing the denial. This response is called an adverse action notice. The most common reasons issued from the lender correlate to the three Cs outlined above: poor credit, insufficient down payment, and excessive current

debt. Looking forward, all of these are curable and can be remedied before a new application is submitted.

2. Request a Second Opinion From the Same Company

Some lenders will entertain a second review of your case if you can present something which has changed since the original application was submitted. Have you paid down a credit card or removed an incorrect account from your credit report? Let the lender know of any updates to your situation and ask them to reevaluate you.

3. Keep Shopping for a Mortgage Lender That Can Better Serve You

A third option is to keep shopping for lenders who might be able to better serve your needs. Not all lenders have the same underwriting standards or metrics. Just because your financial situation doesn’t match the first lender’s criteria, that does not mean it won’t match the next lender’s requirements.

8. The Home Purchase Closing Process When Using a Mortgage Loan

Congratulations! You have made it to closing on your new home. After your mortgage loan is fully approved, the closing date should be just around the corner. While the finish line may be in sight for you, it's not yet the end of the home buying process. So be prepared to do a little more waiting and perform a few more tasks.

Here is what you can expect a few days before closing, at the closing table, and after the transaction has been completed.

Just Before the Purchase Closing Date

Shortly before your actual closing appointment, you may be allowed to do a final walk-through of the home to ensure everything is as remembered and no major damage has taken place since you saw it last. This will typically happen 2-3 days prior to closing. If problems are discovered, you can request a delay in closing, have the seller deposit money into escrow to cover necessary repairs, or remedy it in another way.

Parties Typically Involved on Closing Day

At the closing appointment, many parties will be involved. Knowing who they are in advance can be helpful. Here is a list of parties who may be at the purchaser's and seller's closing meetings. These meetings are typically done at separate times on the same day, or within a day or two of each other.

1. Closing Agent
This person is responsible for coordinating the activities, individual appointments, and paperwork necessary for the closing of the home purchase.

2. Attorney
Often, the closing agent will be an attorney; however, both sides may have separate attorneys. It can often be useful to have an attorney representing just you, as many of the proceedings and documents will not be easily understood.

3. Title Company
The title company will send documentation to prove the seller's current ownership of the property being sold and document the new owner.

4. Home Seller
An individual, more than one person, or business selling the home. They will need to sign various forms and prove their identity to release the property. The seller typically won't have to bring any money to the closing table and can expect to receive whatever funds are due to them within a couple of days.

5. Real Estate Agents
Both the buyer and the seller may have real estate agents present if they choose.

6. Lender
This is the party responsible for providing funding for the home purchase through a mortgage loan and will ensure all of the necessary documentation is available to sign.

7. Home Buyer
Also known as the mortgagor, will need to sign various forms and provide adequate identity information to finalize the purchase. The home buyer may also need to bring a cashier's check as payment to cover some of the closing costs.

All parties will be notified by the escrow officer of their responsibilities ahead of time.

At the Closing Appointment

At the closing appointment, also referred to as the closing table, borrowers will have the following responsibilities:

1) Sign Legal Documents
The amount of paperwork can be significant at closing; however, the legal documents will fall into two main categories: an agreement between you and the seller, and an agreement between you and the lender. Be sure to read all these documents and hire professional help (attorney) if you don't feel confident about what you are signing. The closing agent will help with some general questions.

2) Pay Closing Costs and Escrow
Fees associated with obtaining the loan and transferring the property need to be accounted for at closing. This can typically be done by paying them out-of-pocket, or the lender can roll this amount into your mortgage loan. Be sure to check with your lender prior to closing to ensure you know exactly the amount to have available to pay closing costs.

Escrow Accounts

An escrow account holds funds by a third party in the other party's account. The main escrow account in relation to your new home ensures you pay your property taxes and homeowner's insurance on time. The lender will require this to protect them against loss if you don't pay.

Typically, the lender requires you to deposit two months' worth of property taxes and insurance in this account at the time of closing. Throughout the year, this amount may fluctuate with changes in property taxes or insurance premiums. The amount is most often lumped into the monthly mortgage payment to be of less confusion for the borrower.

After the Closing Documents Have Been Signed

Once both parties sign their individual closing documents, the proper paperwork is sent to the mortgage lender so they can release the buyer's funds to the seller.

After the funds are released, the county receives a notification and records the deed with the new homeowner's name and information. Once this is completed, they will receive recording numbers and notify the escrow company so they can pass them along to the buyer's real estate agent.

Now the deal has officially closed, and the property belongs to the buyer. Only at this time are the keys allowed to be given to the buyer, unless the buyer and seller have reached another agreement – which is not very common.

Which Paperwork Should You Keep?

Throughout this process, there will be several forms and documents which can get confusing. Ask your real estate agent for a hard copy of your final purchase & sale agreement, along with all supporting documentation. Then you can discard any previous copies you may have lying around.

Also, at closing, you should receive a packet full of documentation and paperwork you filled out. You should hang on to all of these documents for your personal records as well. Double-check with your real estate agent to get their recommendations about what to keep and find out if there is any more documentation you need.

Congratulations, you've bought a home!

9. Making Your New Monthly Mortgage Loan Payment

Once closing has taken place and the property has been transferred to you, the mortgage is just getting set up and processed. A common question among recent homebuyers is when the first monthly mortgage loan payment is due and where you'll need to send your payments. We'll address these questions below.

Mortgage Servicer vs. Mortgage Lender

Often, the lender who originated your home loan is not the party that will hold the loan moving forward. Many mortgages are sold on the secondary market, at which time a different company and mortgage servicer would then be responsible for the day-to-day management of your loan.

Responsibilities of the Mortgage Servicer

1. Collect your monthly payments
2. Forward the payments to the current owner of the mortgage (if sold since origination)
3. Pay your property taxes and home insurance from your escrow account
4. Prepare and distribute your annual mortgage statement showing where your payments are going (interest, principal, taxes, insurance, etc.)
5. Assist you in the event of a missed payment or delinquent account. The servicer will contact you, if possible, to arrange a new payment structure until you can regain the proper payment schedule. If this is not successful, then foreclosure may be pursued by the lender.

If you haven't received a mortgage loan payment statement or other letter explaining the payment situation within 30 days after closing, then you should contact the mortgage lender you worked with to buy the home to find out who to send your payments to. Usually, an initial mortgage payment is included in your closing costs, so you should have at least 45-60 days after closing to make your first monthly payment.

Changes in Monthly Payment

The monthly payment on a mortgage can change, even if the mortgage is a fixed rate loan, as opposed to an adjustable-rate one. With a fixed-rate mortgage, the changes may be due to variations in the property taxes, homeowners insurance, or other costs. With adjustable-rate mortgages (ARM) these changes may occur more often and can be more dramatic with shifts in the interest rate.

Fixed-Rate Loans

Fixed-rate mortgages will, for the most part, have steady monthly payments. The changes due to property taxes and homeowners insurance will change the amount you need to put in escrow, which ultimately impacts your monthly mortgage payment.

An escrow adjustment will be made at the end of the year if needed, and often it takes effect in February. For this reason, it is advisable to set aside extra funds in the preceding months in preparation for a change in the monthly mortgage payment.

Adjustable-Rate Mortgage Loans (ARMs)

Since the interest rate on adjustable-rate mortgages shift with fluctuations in the interest rate market, payments can be volatile. A seemingly small increase in interest rates can correlate to a large jump in the mortgage payment.

Since ARMs usually have lower introductory rates than fixed-rate mortgages, it is a good idea to put the money saved aside during the first few years on the ARM in preparation of rate increase. One cannot assume rates will remain stable or decrease, so the borrower must be aware from the beginning that their mortgage payments will likely rise.

10. Reasons for Refinancing Your Home Loan, Including Removing PMI or MIP

Two important issues that commonly arise over the years of paying down a mortgage loan are how to remove the mortgage insurance (if applicable) and determining if you should refinance your home loan. Both have an impact on your overall financial picture, so it is beneficial to understand the ins and outs of each.

Removing Mortgage Insurance from Loan Payments

Cancel Private Mortgage Insurance (PMI) – Conventional Loans

If you decided to secure a conventional mortgage loan, the most common type of home loan, with less than a 20% down payment, chances are high you have Private Mortgage Insurance (PMI). However, once your equity in the home reaches 20%, you should be eligible to remove the PMI upon request. At 22% equity it's supposed to fall off automatically.

Private mortgage insurance protects a lender against loss if a borrower defaults on their loan and enables borrowers with less cash to have greater access to homeownership. But it does not provide any protection against default for the borrower.

At closing, the lender is required by law to outline how many years and months it will take to pay the loan down to a point where you can remove PMI. Mortgage servicers are required to cancel the insurance once the loan-to-value reaches 78%. A borrower should request this is done at 80% however, to save money, which is acceptable in most circumstances.

A time when PMI may not be removed at 20% equity is when the loan was made, and the lender identified the borrower as high risk. In this situation, the lender could require PMI to remain on the loan until reaching 50% equity. You can also enter this high-risk profile if you miss mortgage payments regularly or you no longer use the property as a primary residence.

Calculating Home Equity

The calculation to determine the equity in a home is straightforward. This is done by subtracting the loan balance from the appraised value of the home. For instance, if the home is worth $200,000 and the outstanding loan balance is $150,000, the borrower is said to have $50,000 in equity in the property.

To calculate the percentage, you would then take this equity portion and divide it by the value of the property. In this case: $50,000 / $200,000 equals 25% equity. In most circumstances, this borrower would be eligible to eliminate the PMI once they've reached this point.

Remove Mortgage Insurance Premium (MIP) – FHA Loans

If you received your FHA loan before June 3, 2013, you are eligible for MIP cancelation after five years as long as you have 22% equity in the property and made all of your monthly mortgage payments on time.

New FHA loans now require mortgage insurance premiums to be paid for the life of the loan unless you put at least 10% down on the home and have owned it for 11 years. At which time you can request to cancel the MIP. Otherwise, you will need to refinance into a conventional loan, or pay it off another way to remove the added cost.

Common Reasons to Refinance a Home Loan

Beyond saving money by removing mortgage insurance premiums from the monthly mortgage payment, there are various other reasons for a borrower to pursue refinancing of their home loan:

- Credit score has increased making the borrower eligible for lower rates
- Borrower wants to switch the type of mortgage (adjustable rate to fixed for example)
- Borrower wants to shorten or extend the length of the mortgage loan
- Borrower wants to take advantage of their home equity and withdraw it as cash
- Interest rates have come down and borrower wants to save money over the life of the loan

The final two bullet points above are typically the most common reasons people choose to refinance their home loan.

With either case, a borrower must weigh the total cost of the refinance against the long-term savings. Often, refinancing will require various closing costs, which can be substantial.

Final Thoughts on Refinancing Home Loans

When evaluating the financial benefit of a mortgage refinance, a borrower should think of how long they will remain in that property, and if the upfront costs of refinancing will be regained over that time period. It's a good idea to find a lender that you can trust and ask them a handful of questions before making your decision.

11. How to Avoid a Home Foreclosure

Nobody buys a home and signs a mortgage agreement with the intent of abandoning their home. However, it can happen when unexpected hard times or financial challenges arise. The absolute most important thing to do in times of distress is to communicate with your mortgage lender. This lays the groundwork for being able to avoid the negative ramifications of foreclosure when possible.

Mortgage lenders are not in the business of owning real estate and would rather not foreclose on your property. Doing so causes a significant hassle, and in many cases, financial loss to the lender. For this reason, lenders are willing to work with struggling borrowers to come to some kind of arrangement.

Even so, it's important to understand the foreclosure process in case you need to get out of a sticky situation.

The Home Foreclosure Process

The home foreclosure process usually begins with a missed payment to a mortgagee. Typically, 16 days after payment is not received. The mortgage servicer will contact the borrower to determine what is going on, and possibly arrange a new payment structure.

After 30 days, the loan servicer will begin collection attempts, perhaps employing outside agencies. After 90 days, an attorney is usually contacted, and foreclosure legal proceedings are initiated. The foreclosure process can take a while and the borrower can stay in the property until it is sold. The entire process can take several months depending on the state the real estate resides in.

After the foreclosure procedure is initiated, the borrower typically has a short amount of time to bring the loan current. This period is known as the redemption period. If the loan is not made whole by the borrower, the property will go to auction.

If the proceeds of the auction don't cover the amount due to the lender, it can initiate a deficiency judgment against the debtor for the difference between the amount collected at auction and the remaining loan balance. Obviously, this can present substantial financial challenges to the borrower.

Foreclosure Alternatives

Fortunately, there are alternatives to foreclosure that can limit the financial blow to both the borrower and the lender. Here are a few options which are typically presented by lenders in times of delinquency in order to avoid foreclosure:

Repayment Plan

When borrowers can't make a mortgage payment due to an unforeseen expense such as an urgent medical procedure but still have the capacity to make payments in the future, a repayment plan may be offered by the lender. A repayment plan allows borrowers to overpay for the next few months in order to get caught up on the mortgage.

Loan Modification

A modification of the terms of the loan can help if a borrower is having trouble with the current agreement. This is typically done by extending the length of the loan or lowering the interest rate to reduce the monthly payment. These loan modifications can save a borrower from foreclosure, so long as the updated payment terms are met.

Short Sale

A real estate short sale is when the lender agrees to allow a borrower to sell the home for less than the outstanding balance due and forgive the remaining balance. This allows the homeowner to avoid foreclosure, and the lender realizes cash flow without foreclosing on the home.

When debt is forgiven by the lender it may be considered taxable income. Borrowers should consult with a tax advisor to understand the consequences of a short sale before taking this route. It can leave borrowers with a huge financial tax burden they didn't expect.

Final Thoughts on How to Avoid Foreclosure

Each of these options is available at the discretion of the lender. Not all of them are viable solutions for all homeowners who are struggling to keep up with mortgage payments. If you are having trouble making your monthly mortgage payment, the best thing you can do is get in contact with the lender as soon as possible to discuss your options.

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