

Loan Programs

Fixed Rate ■ Conventional ■ Jumbo ■ Subprime ■ ARM ■ FHA ■ VA

Fixed Rate Mortgages

This is the most common type of mortgage program, where your monthly payments for interest and principal never change during the course of the loan. Property taxes and homeowners insurance may increase, but generally your monthly payments will be very stable.

Fixed rate mortgages are available for 30 years, 20 years, 15 years, and even 10 years. There are also "biweekly" mortgages, which shorten the loan by calling for half the monthly payment every two weeks. (Since there are 52 weeks in a year, you make 26 payments, or 13 "months" worth, every year.)

Fixed rate fully amortizing loans have two distinct features. First, the interest rate remains fixed for the life of the loan. Secondly, the payments remain level for the life of the loan and are structured to repay the loan at the end of the loan term. The most common fixed rate loans are 15-year and 30-year mortgages.

During the early amortization period, a large percentage of the monthly payment is used for paying the interest. As the loan is paid down, more of the monthly payment is applied to principal. A typical 30-year fixed rate mortgage takes 22.5 years of level payments to pay half of the original loan amount.

Conventional Loans

Conventional loans are secured by government-sponsored entities or GSE such as Fannie Mae and Freddie Mac or by private investors for loan amounts higher than the limits set by the GSE. Conventional loans can be made to purchase or refinance homes with first and second mortgages on single family to four-family homes. In general, Fannie Mae and Freddie Mac's single family, first mortgage loan limit is \$333,700 in 2004. This limit is reviewed annually and, if needed, changed to reflect changes in the national average price for single-family homes. The current loan limit applies to all conventional mortgages delivered after January 1, 2004. 2004 Limits are as follows:

First mortgages

- One Family loans: \$333,700
- Two Family loans: \$427,150
- Three Family loans: \$516,300
- Four Family loans: \$641,650

Maximum original loan amounts are 50% higher for first mortgages on properties in Alaska, Hawaii, Guam and the U.S. Virgin Islands.

Second Mortgages

- \$150,350 (in Alaska, Hawaii, and the US Virgin Islands: \$225,525)



Loan Programs, continued ...

Jumbo Loans

Loans that are larger than the limits set by Fannie Mae and Freddie Mac are called jumbo loans. Because jumbo loans are not funded by these GSE, they usually carry a higher interest rate and some additional underwriting requirements. A strategy to lower your overall interest payments if your purchase or refinance balance is above \$333,700 is to use a combination of both first and second trust money, referred to as an 80/10/10, 80/15/5 or 80/20. Every situation is different, but it is one more option to consider.

In addition to common loan structures such as fixed rate, adjustable rate and balloon loans, Fannie Mae and Freddie Mac also have loan programs for low-to-no down payments, community lending, and affordable housing initiatives, construction-to-permanent, home improvement, and reverse mortgages.

Subprime Loans

If you have CREDIT CHALLENGES, you may not qualify for a conventional loan or low down payment loans offered by FHA and VA. In this case, you may consider a subprime mortgage. Because of the higher risk associated with lending to borrowers that have a poor credit history, subprime loans typically require a larger down payment and a higher interest rate.

You should study the specific terms of a subprime loan that you qualify for to determine if it is a loan that will help your financial situation. Subprime loans are one way for you to get into the home you want at today's price. If you already own a home, a subprime loan can give you an opportunity to clean up your credit and ultimately refinance into a lower rate at a later time. If you have a mortgage, you can look at refinancing more than what you currently owe on the house and get cash back for the equity you already have in the home. This cash-out could be used to pay off higher rate credit cards, bankruptcy, foreclosure, or collections and liens. It could be a good way to clean up a troubled credit history, save money each month, and start rebuilding your credit worthiness.

Whether for a purchase or refinance, subprime loans should typically be used as a short-term solution, approximately two to four years. During that time, you can work to clean up your credit and qualify for a refinance into a lower risk, lower rate loan.

Prior to 1990 it was very difficult for anyone to obtain a mortgage if they did not qualify for a conventional, FHA, or VA loan. Subprime loans were developed to help higher risk borrowers obtain a mortgage. Many borrowers with bad credit are good people who honestly intended to pay their bills on time. Catastrophic events such as the loss of a job or a family illness can lead to missed or late payments or even foreclosure and bankruptcy. Now there are mortgage companies that take into consideration events outside the borrower's control, but not without a price.

Lenders are compensated for risk in the form of interest rates. The higher the lender perceived its risk to be, the higher the rate they will charge for the privilege of borrowing their money. The lower the risk, the lower the rate. Several risk factors are taken into consideration when evaluating a borrower for a sub prime mortgage, the most important being your payment and credit history.

Your debt to income level, employment history, type of property, and assets are other factors that are taken into consideration when determining if you qualify for a conventional, government, or subprime loan.



Loan Programs, continued ...

Adjustable Rate Mortgage (ARM)

The popularity of adjustable rate mortgages rises and falls depending upon the overall direction of interest rates as well as the spread between fixed rate mortgages and adjustables. There are many reasons why one might opt for an adjustable rate mortgage. In analyzing whether you might be a viable candidate for an adjustable, there are many facets you may want to consider before making a decision:

What is the current interest rate spread between a fixed rate and an adjustable? Fixed mortgage rates are based upon long-term interest rates while most adjustables are based upon short-term rates. For example, a one-year adjustable will typically be priced off current one year Treasury Bills, or T bills. Short-term rates are typically lower than long-term rates, which is why adjustables will have starting rates below fixed rate loans. The difference between the two—known as the *spread*—is not always the same. If fixed rates are at 8.00% and a one-year adjustable starts at 4.00%, the benefit is clearly seen. If the adjustable starts at 7.50%, the choice is not so clear.

How long are you going to keep the mortgage? Note that the question here is not how long will you live in the house. If you convert the home to rental property some time in the future, you will still be making payments on the mortgage. Also, you may refinance the mortgage in the future and remain in the property. Factors that might affect your long-term use of the mortgage might be your job stability, mobility and the current interest rate of the mortgage. For example, if you purchase a home and obtain a mortgage during a period of relatively high mortgage rates, a refinance is more likely in the future. The average life of a mortgage in the United States has fallen to below five years—a significant argument on the side of adjustables.

Which direction do you think mortgage rates will move in the future? If you feel that the present level of rates is high and the movement is likely to be down, you are more likely to benefit from an adjustable. Note that anyone's opinion of the future of interest rates is just that -- an opinion. Yet, if rates have recently moved up, they are more likely to move lower in the future.

What is the life cap of the adjustable as compared to the present level of fixed rates? The major advantage of fixed rates over adjustables concerns the issue of security. With a fixed rate mortgage one will be secure in having the knowledge of their payment over the life of the loan. With an adjustable, long term security comes in the form of a cap on the mortgage rate. This cap is the maximum rate over the life of the loan. If this maximum is close to the present level of fixed rates, then we can say that the worst case is palatable. If 30 year fixed rates are presently 8.00% and the life cap of an adjustable is 9.50%, the risk is minimal.

How fast do you expect your income to rise in the future? If you expect your future income growth to be strong, it may make sense to opt for an adjustable. Your payment will be lower in the short run when your financial plan most needs the assistance.

As you make your decision it is important to also consider the fact that all adjustables are not alike. Some may have interest changes each month, while others may be fixed for the first 10 years of the mortgage. A 10-year adjustable provides security and will typically offer a lower rate than fixed rate alternatives. The more frequent the changes, the lower the starting rate of the ARM. Most adjustables have caps that limit the amount of change per each adjustment. Most one-year adjustables have annual caps ranging from 1.00% to 2.00%.

Another difference between adjustables concerns the index upon which future rate changes are based. Some indices may have a history of being more stable in times of market volatility. In particular, the 11th District Cost of Funds Index (COFI) tends to change more slowly (lagging) than indices based upon T Bills. This would make COFI based adjustables better performers during periods of rising rates, but disadvantageous when rates are falling. The right mortgage product today just might become the wrong choice tomorrow. Your economic circumstances may change which would alter your choice. It seems that the external economic environment is forever changing. Surely, if we could predict the future of interest rates the decision would be easy. Yet with careful planning and knowledge of alternatives, we can improve the chances!



Loan Programs, continued ...

FHA Loans

From Janet Wickell, www.hombuying.about.com

An FHA loan allows you to buy a house with as little as 3% down, instead of the higher percentages required to secure many conventional loans. Taking advantage of the FHA loan program is a great way for first-time buyers, or anyone with a shortage of down payment funds, to buy a home. The FHA does not *make* home loans – it *insures* them. If a homebuyer defaults, the lender is paid from the insurance fund. To get an FHA home loan, you'll need to have a good credit history and sufficient income to qualify for the loan.

How Much FHA Loan Can You Afford?

An important FHA consideration is your debt to income ratio (DTI). Traditionally, for an FHA loan, your monthly housing costs should not exceed 29% of your gross monthly income [However, **a good mortgage broker has access to programs with more accepting DTI ratios, up to 45%**]. Total housing costs include mortgage principal and interest, property taxes, and insurance. Those four terms are often lumped together, and referred to as PITI.

Example Monthly income X .29 = Maximum PITI
For a monthly income of \$3,000, that means
\$3,000 x .29 = \$870 Maximum PITI

The ratios for an FHA loan are more lenient than for a typical conventional loan. For conventional home loans, PITI expense cannot usually exceed 26-28% of your gross monthly income, and total expense should be no more than 33-36%.

Qualifying for an FHA Loan

- To obtain an FHA loan, you must have a credit background that shows you meet your obligations
- You must have enough income to pay your monthly debt

Other issues that can be worked around by a professional mortgage broker

- You must have enough cash to make a down payment at the time of closing
- You must be able to pay the closing costs, which normally total 2-3% of the price of the home. These costs might include homeowner's insurance, attorney's fees, fees for a title search and title insurance, Private Mortgage Insurance if you are paying less than 20% down, the loan origination fee, and a fee that goes into the FHA insurance fund
- You might also be paying "points" to the lender. Each point equals 1% of the cost of the home. Sometimes a seller will agree to pay your points, and sometimes points can be financed



Loan Programs, continued ...

VA Loans

Question: Can I get a VA loan if I have had a bankruptcy in the last few years?

Answer: VA credit standards state that a veteran with a bankruptcy less than 3 years ago would generally not be considered a satisfactory credit risk unless: the veteran or spouse has obtained items on credit since the bankruptcy and has paid the obligations in a satisfactory manner for a continued period; and the bankruptcy was caused by circumstances beyond the control of the borrower, which would have to be verified. A bankruptcy discharged 3 to 5 years ago must be given some consideration in the underwriting of the loan. A bankruptcy discharged more than 5 years ago may be disregarded. These are the minimum standards that mortgage companies must follow when making a VA loan. In 95% of the cases, companies make the decision to approve a loan without VA's prior approval. Keep in mind that mortgage companies also have money at risk in giving you a VA loan, so they may have stricter credit standards than those mandated by VA.

Question: How big of a loan can I get? If my guaranty entitlement is \$36,000, does this mean I am limited to a \$36,000 loan?

Answer: There is no limit on the size of a VA guaranteed home loan, provided that the veteran is qualified for the loan from a credit and income standpoint. However, as a practical matter, companies will generally limit the maximum loan amount to 4 times the amount of the veteran's available entitlement plus any down payment. Currently, the maximum entitlement on loans above \$144,000 is \$50,750, which will support a no down payment loan of up to \$203,000.

Question: Why do I have to pay a fee for a VA home loan? Since I paid a fee for my first loan, why is there a larger fee for my second loan?

Answer: The VA funding fee is required by law. The fee, currently 2 percent on no down payment loans, is intended to enable the veteran who obtains a VA home loan to contribute toward the cost of this benefit, and thereby reduce the cost to taxpayers. The funding fee for second time users who do not make a down payment is 3 percent. The idea of a higher fee for second time use is based on the fact that these veterans have already had a chance to use the benefit once, and also that prior users have had time to accumulate equity or save money towards a down payment. Second time users who make a down payment of at least 5 percent pay a reduced funding fee of 1.5 percent, the same as first time users making the same down payment. For a 10 percent down payment, the fee drops to 1.25 percent. The effect of the funding fee on a veteran's financial situation is minimized since the fee may be financed in the loan.

Question: May a veteran join with a nonveteran who is not his or her spouse in obtaining a VA loan?

Answer: Yes, but the guaranty is based only on the veteran's portion of the loan. The guaranty cannot cover the non-veteran's part of the loan. Consult mortgage companies to determine whether they would be willing to accept applications for joint loans of this type. Mortgage companies that are willing to make these types of loans will likely require a down payment to cover risk on the un guaranteed, non veteran's portion of the loan. Unlike other loans, the mortgage company must submit joint loans to VA for approval before they are made. Both incomes can be used to qualify for the loan. However, the veteran's income must be sufficient to repay at least that portion of the loan related to the veteran's interest in (portion of) the property and the non veteran's income adequate to cover the rest.

