

A Plain & Simple Guide For First Time Home Buyers

Mortgage Bankers Association of America

You're going to meet a complete stranger. You're asking for more money than you've ever seen in your life. And all your hopes are riding on the answer.

No wonder you're nervous about getting your first mortgage! That's natural. And it's also natural to be at least a little bit confused. After all, people are using expressions you've probably never heard before, talking about loans you're not familiar with. You probably feel overwhelmed with information. And unsure of how to sort it out and make the right choices. That's why we built this section of our web site — to make the process of getting financing for your home a little less nerve-wracking. And a lot less confusing. Read over this section carefully and then head on over to our planning tools to get started on owning your first home!

Getting Started

Many people buying their first home are afraid lenders don't really want to work with them. But that's simply not true. Without you, there would be no mortgage lending business. Lenders want to help you buy your first house!

Q I really want to own my own home, but I'm not sure I can afford it. Where do I start?

A Lots of people don't even consider buying a home because they're afraid they can't afford it. But for most people, home ownership is within reach — especially with some of the special programs for first-time home buyers. In fact, for many, home ownership is as affordable as renting — in some cases even more affordable. Use our rent vs. own calculator to help you determine what is best for you.

The best place to start is with a mortgage lender affiliated with the Mortgage Bankers Association of America; a lender can help you explore all the options of home ownership.

Q How do I know how much house I can afford?

A Before you start looking at homes, you need to have some idea of what you can afford. As a general guide, you can purchase a home with a value of two to three times your annual household income, depending on your savings and debts. However, you may be able to take advantage of special loan programs for first time buyers to purchase a home with a higher value. Use our "what home can I afford" planning tool to better get a fix on this.

If you'd like to know more exactly how much you can afford, talk to a mortgage lender. If you're working with a Realtor®, he or she can help you with this, too.

Q When should I talk to a mortgage banker?

A The short answer: when you start thinking about buying a home. It's true you can't actually apply for a mortgage until you've chosen your home and signed a contract to buy it. But you shouldn't wait until then to start talking with a mortgage lender.

Any reputable mortgage lender will be happy to help you as you look for a home. The lender will work with you to determine how much house you can afford, help steer you to special mortgages for first time home buyers, and perhaps make suggestions that could make it easier to get the best mortgage for you.

Another advantage: you'll already have a good relationship with a lender when it comes time to apply for your



mortgage.

How to Make Your First Meeting Work

Many different institutions make mortgage LOANS, including banks, savings and loans, credit unions and, of course, mortgage companies.

Whatever type of mortgage lender you go to, he or she will need some information from you to help you learn how much house you can afford. So when you go to your first meeting, try to bring the following information with you.

About your employment and income

- ✦ Your employment, salary and bonuses, and any other source of income for the past two years (bring your tax returns or W-2 forms if possible);
- ✦ The amount of any dividend and interest income you received during the last two years;
- ✦ The amount of any other regular income you may receive (alimony, child support, etc.).

About your personal assets

- ✦ Current balances and recent statements for any bank accounts, including both checking and savings;
- ✦ Current market value of any investments you may have such as stocks, bonds, or Certificates of Deposit;
- ✦ Interest in retirement funds, if any;
- ✦ Face amount and cash value of life insurance policies, if any;
- ✦ Value of any significant pieces of personal property, including automobiles.

About your credit and debts

- ✦ The balances and account numbers of your current loans and debts, including car loans, credit card balances, and any other loans you may have.

Decisions, Decision, Decisions....

When our parents were buying homes, there was basically one kind of mortgage: the 30-year fixed rate. Today, you can choose from many different kinds of mortgages. It may seem confusing — but these new kinds of mortgages can make home ownership more affordable.

Q Aren't there really just two kinds of mortgages: fixed and adjustable rate?

A You could say that, because all mortgages fall into one of these two categories — that is, the interest rate you pay is either the same (fixed) for the life of the mortgage, or it can change (adjust) over the life of the mortgage (see The Low-down on Loans).

But within these two broad categories, there are many different kinds of mortgages, designed to fit people in different financial situations — and many of them are especially for first time home buyers (see First Class Help for First Time Buyers).



Q How do I know which type of mortgage is best for me?

A There isn't a single, simple answer to this question. The right type of mortgage for you depends on many different factors:

- ✦ Your current financial picture;
- ✦ How you expect your finances to change;
- ✦ How long you intend to keep your house;
- ✦ And how comfortable you are with your mortgage payment changing from time to time.

For example, a 15-year fixed rate mortgage can save you many thousands of dollars in interest payments over the life of the loan, but your monthly payments will be higher. And an adjustable rate mortgage may get you started with a lower monthly payment than a fixed-rate mortgage — but your payments could get higher when the interest rate changes.

The best way to find the "right" answer is to discuss your finances, your plans and financial prospects, and your preferences frankly with a mortgage lender. Get a jump start on this at any time by using our planning tools to better determine your specific situation.

Q What does my mortgage payment include?

A For most homeowners, the monthly mortgage payments include three separate parts: a payment on the principal of the loan (that is, the amount borrowed); a payment on the interest; and payments into a special account (called an escrow account) that your lender maintains to pay for things like your hazard insurance and property taxes. These elements are called P.I.T.I. (Principal-Interest-Taxes-Insurance).

Q How much will I need for the down payment?

A It's probably less than you think. Many first-time buyers are surprised to learn there's no set answer to this question. Generally, though, your down payment can be anywhere from three to twenty percent of the home's value. Down payments can be lower for some special, first-time buyer loans, and veterans or those on active military service can obtain loans with no down payment at all.

First Class Help for First Time Buyers

There are many special programs and that can make getting a first mortgage easier. Some of the better-known national programs include:

FHA (Federal Housing Administration)

Loans are government-insured mortgages primarily for first-time home buyers. These loans allow you to buy a home with a lower down payment, and come with guidelines that let more people qualify. They're available from most mortgage lenders. There may be specific benefits and restrictions to FHA Loans in your area; ask your mortgage lender.

VA (Veterans Administration)

Loans are available to veterans of the armed services, those currently on active duty or in the reserve, and their



spouses. A VA loan can make it possible to buy a home with no money down.

Rural Housing and Community Development Service (RHCD)

RHCD provides home financing to qualified borrowers who are unable to obtain home financing elsewhere. If you are a farmer, or live in a rural area, ask your mortgage lender if you may qualify.

There are many other loan programs that offer homebuyers low down

payments and have guidelines that let more people qualify. They may be administered by state or local governments, or other organizations. Be sure to ask your mortgage lender what other programs are available in your area especially for first-time home buyers.

Applying Yourself

For many home buyers, the process of selecting and applying for mortgage lender is expecting from you.

Q How do I choose a type of mortgage?

A Discuss the options with a mortgage lender (and today you have many options — see The Low-down on Loans). Only a mortgage lender is qualified to evaluate your financial situation and match your needs with the best available type of mortgage.

Q Do they really need to know everything about me for the application?

A It may seem that way — but actually all your mortgage lender needs to know about you is your employment and finances, and information about the home you're buying.

However, you will need to provide quite a few details about these topics, and your application process will go much more smoothly if you're prepared. Be sure to ask your mortgage lender what information you'll need to complete your application.

Q How much will my credit history affect my ability to get a mortgage?

A Many home buyers are very worried about this issue. We've even heard one story that an applicant was denied a mortgage because he had returned a rented videotape late!

Of course, that could never happen. And most people don't need to worry about the effects of their credit history. However, you can be better prepared if you get a copy of your credit report to review before you apply for your mortgage. That way, if there are any errors you can take steps to correct them before you make your application.

If you have had credit problems, be prepared to discuss them honestly with your mortgage lender — and come to your application meeting with a written explanation. Responsible mortgage lenders know there can be legitimate reasons for credit problems, such as unemployment, illness or other financial difficulties. If you had a problem that's been corrected, and your payments have been on time for a year or more, your credit will probably be considered satisfactory.



Q What happens after I've applied — and how long will it take?

A Your lender will begin the work of verifying all the information you've provided. This process can take anywhere from one to six weeks, depending on the type of mortgage you choose, whether you're buying a home outside your local community, and other factors.

Within three business days after your application, the lender must give you an estimate of your closing costs. (The closing is the actual settlement of your loan.) You'll also get a statement that shows your estimated monthly payment, the cost of your finance charges, and other facts about your mortgage.

For many home buyers, this waiting period can be nerve-wracking. So stay in touch with your mortgage lender, be prepared to answer any questions that might come up — and remember that mortgage lenders are in the business of making loans, not denying them.

Some homebuyers find the closing process to be one of the most intimidating aspects of buying a home because it's so unfamiliar. Ask your mortgage lender what to expect at your closing.

The Low-down on Loans

Although there are many options for your first mortgage loan, they all fall into one of these general categories:

Fixed Rate Mortgages

Your monthly payments for interest and principal stay the same for the life of the loan. Your 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 "bi-weekly" 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.)

Adjustable Rate Mortgages (ARMS), also called Variable Rate Mortgages

These loans generally begin with an interest rate that is 2-3 percent below a comparable fixed rate mortgage, and could allow you to buy a more expensive home.

However, the interest rate changes at specified intervals (for example, every year) depending on changing market conditions; if interest rates go up, your monthly mortgage payment will go up, too. However, if rates go down, your mortgage payment will drop also.

There are also mortgages that combine aspects of fixed and variable rate mortgages — starting at a low fixed rate for seven to ten years, for example, then adjusting to market conditions.

Balloon Mortgages

These mortgages offer low, fixed rate payments as though the mortgage was a thirty-year term. But instead, the loan has a fairly short term — for example, five to seven years — and then ends with a single large payment (the "balloon") for all the remaining principle. It can be a good choice if you know you'll only be in your home for a short



time.

There are other special kinds of mortgages available now that help achieve specific goals. Ask your mortgage lender or Realtor® for more information about your options.

How to Choose Your Lender

Choosing your mortgage lender can be as important as choosing your home. If you're comfortable with your mortgage lender, getting your mortgage — and your home — will be a less stressful and more pleasant experience.

Rates shouldn't be your only criteria

Once you have a short list of possible lenders, dig a little deeper. Mortgages with the same nominal interest rate can end up costing different amounts, because of additional costs such as origination and application fees (see the glossary for more information). So shop for more than just rates.

In addition, consider how many different types of mortgages a lender offers. A lender with more different types of loans may be better able to match your needs. Finally, ask home owners and real estate professionals about the reputations and knowledge of different lenders.

Fifteen Commonly Used Mortgage Terms

Here are 15 of the most common terms used to describe mortgages. If you hear other terms you don't know, ask your mortgage lender what they mean. You can also look them up in our mortgage terms section.

Adjustable Rate Mortgage (arm, also called Variable Rate Mortgage) -- A mortgage with an interest rate that is adjusted periodically to reflect changes in market conditions. Your mortgage payments are adjusted up or down as the interest rate changes. (See The Low-down on Loans on page 12 for more information).

Annual Percentage Rate (APR) -- An interest rate that reflects the actual cost of a mortgage as a yearly rate. Because APR includes points and other costs, it's usually higher than the advertised rate. The APR allows you to compare different mortgages based on actual annual costs.

Appraisal -- An estimate of the value of a home, made by a professional appraiser. The maximum amount of the mortgage is usually based on the appraisal.

Closing Costs (Settlement Costs) -- All the charges associated with getting your mortgage, including the origination fee, discount points, appraisal fee, title search and insurance, survey, taxes, deed recording fee, charges for credit reports and other costs. Costs of closing usually add up to 3 to 6 percent of the mortgage amount.

Equity -- The value of your home after the outstanding balance of any loans are subtracted.

Escrow -- A special third-party account set up by the lender in which your funds are held to pay for taxes and insurance. "Escrow" can also refer to a third party who carries out the instructions of both the buyer and seller to handle the paperwork at the settlement.



Fixed Rate mortgage -- A mortgage with an interest rate that stays the same (fixed) for the life of the mortgage. Monthly payments for a fixed rate mortgage are very stable. (See the Low-down on Loans on page 12 for more information.)

Interest -- The sum paid for borrowing money, which pays the lender's costs of doing business.

Origination Fee -- The fee charged by a lender to prepare all the documents associated with your mortgage.

PITI (Principal-Interest-Taxes-Insurance) -- Shorthand for the separate parts of a typical monthly mortgage payment

Points (Loan Discount Points) -- Points are prepaid interest on your mortgage, charged by the lender at the time of the closing. Each point is one percent of the loan amount — that is, 2 points on a \$100,000 mortgage would be \$2,000.

Prepays -- The expenses that are put into escrow at closing, usually including real estate taxes, insurance, and interest.

Principal -- The amount of debt, not including interest, left on a loan; also 77 the face amount of the mortgage.

Private Mortgage Insurance (PMI) -- An insurance policy the borrower buys to protect the lender from non-payment of the loan. PMI policies are usually required if you make a down payment that is below 20% of the appraised value of the home.

Title Insurance -- An insurance policy which insures you against errors in the title search, essentially guaranteeing your and your lender's financial interest in the property.

