Selecting the Right Mortgage for You

Selecting the type of mortgage that will best suit your needs is not a simple undertaking. The right mortgage will depend on many different factors, including your financial situation and how you expect it to change in the future, how long you'd like to keep your house, and how comfortable you are with the possibility of your mortgage payment changing.

For example, a 15-year fixed-rate mortgage can save you thousands of dollars in interest payments over the entire term of the loan, but your monthly payments will be greater. With an adjustable-rate mortgage, you may start with a lower monthly payment than a fixed-rate mortgage -- but your payments could increase when the interest rate changes.

The best way to find the right mortgage for you is to discuss your finances, plans and preferences with a mortgage professional, whom your REALTOR® can recommend.

Fixed-Rate Mortgages

Fixed-rate mortgages, the most common type of mortgage, offer consistently stable monthly payments. Your property taxes and homeowner's insurance may increase, but your monthly payments typically won't fluctuate.

With fixed-rate mortgages, you have the option of choosing a 30-year, 20-year, 15-year or 10-year repayment plan. You also may shorten the loan through a biweekly mortgage, thereby allowing you to make the equivalent of an extra month's payment per year. In selecting the length of your repayment, remember that a shorter loan carries higher payments but accrues less interest and allows you to build equity quicker.

Adjustable-Rate Mortgages

The interest rate on an adjustable-rate mortgage (ARM) is dictated by changing market rates. When interest rates rise, your monthly payments will go up, and when interest rates decrease, your monthly payments will go down accordingly.

ARMs often provide a lower initial interest rate than fixed-rate mortgages, attracting people who need lower payments early in the loan in order to qualify for a mortgage. ARMs also can benefit people who plan to move or refinance in the near future or those who expect their incomes to increase in the coming years.

Before applying for an ARM, find out how high your monthly payments can go throughout the life of the loan. An ARM includes two caps or limits on interest rate increases; one cap states the

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boundary for how high your interest rate can go up during each adjustment period, and the other cap sets the maximum total amount of all interest adjustments over the entire term of the mortgage.

The rates of an ARM typically change once or twice a year, and there is usually a lifetime cap on both the individual rate adjustments and the total amount the rate can change over the life of the loan. By applying the terms of the caps to your mortgage payments, you can anticipate the worst-case scenario prior to applying and determine if this figure is in line with your finances.

Reverse Mortgages

A reverse mortgage is a special type of loan made to senior homeowners that allows them to convert the equity in their homes to cash for living expenses, home improvements, in-home health care, or other needs.

A reverse mortgage takes its name from its reversed payment system. Instead of monthly payments by the borrower to the lender, the lender makes monthly payments to the borrower. With a reverse mortgage, older homeowners can stay in their homes and maintain or improve their standard of living without taking on a monthly mortgage payment.

To obtain a reverse mortgage, you must meet certain criteria that differ greatly from the qualification requirements for other mortgages. Reverse mortgages are generally limited to borrowers 62 years or older who own their own homes either outright or nearly so. Homes also must be clear of tax liens. And, unlike other mortgages, seniors don't have to meet income or credit requirements to qualify for a reverse mortgage.

Borrowers typically have the option of receiving the reverse mortgage's proceeds in the form of a lump-sum payment, fixed monthly payments for life, or a line of credit. A reverse mortgage's interest rate is usually an adjustable rate that fluctuates monthly or yearly. However, the size of monthly payments that borrowers receive doesn't change.

Balloon Mortgages

Balloon loans are short-term mortgages with some of the features of a fixed-rate mortgage, like low interest rates, but without the benefit of full amortization. As opposed to a 30-year fixed-rate mortgage, balloon loan payments only cover part of what you've borrowed during the term of the loan. At the end of the term, you're required to pay off the loan's balance by refinancing or making a lump-sum payment.

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Balloon mortgages are typically five-, seven- or 10-year loans, so they can be beneficial to borrowers who anticipate selling or refinancing their homes in a short period of time.

Many companies offer a conversion feature at the end of the loan's term. For example, the loan may convert to a 30-year fixed loan at the 30-year market rate plus a certain percentage point. To qualify for a conversion, you usually need to be in good standing with the payments on your balloon loan. Balloon mortgage programs with conversion options are also called a 7/23 convertibles or 5/25 convertibles.

Buy-down Mortgages

Today's mortgage lenders have developed variations on the old buy-down method of offering an interest rate that is 2 percent below the fixed rate for the first year and 1 percent below the fixed rate for the second year, followed by 28 years of paying the regular fixed rate. Buy-downs now charge higher interest in the beginning of the loan to cover the future yields.

For example, if the current market rate for a fixed-rate loan is 8.5 percent at a cost of 1.5 points, the buy-down gives the borrower a first-year rate of 6.5 percent, a second-year rate of 7.5 percent and a third- through 30thyear rate of 8.5 percent. The cost would be 4.5 points.

Location Efficient Mortgages

Location Effecient Mortgages are available through a partnership between Fannie Mae and private lenders for homebuyers in select communities nationwide. In California, LEMs are available in the San Francisco Bay and Los Angeles areas. The are targeted to consumers who live in areas where public transportation is available, reducing the need to rely on cars, as well as the costs associated with doing so. The LEM is a fixed interest rate, 15- to 30-year mortgage that requires a downpayment of at least 3 percent of the appraised value of the property and has a 97 percent loan-to-value (LTV) ratio.

Government Loans

The Federal Housing Administration (FHA), the U.S. Department of Veterans Affairs (VA), and the Rural Housing Services (RHS) are agencies that offer government-insured loans. To obtain these loans, you must apply through a lender that is approved to provide them. All of these agencies require certain minimum standards for the properties being purchased.

Through the FHA, you can purchase a home with a very low downpayment, typically 3 percent to 5 percent of the FHA-appraisal value or the purchase price, whichever is lower. In addition, the FHA's applicant standards are more lenient than conventional loans; you don't necessarily

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have to have a spotless credit record or a high-paying job to qualify. FHA mortgages have a maximum loan limit that varies depending on the average cost of housing in a particular region.

The VA program allows qualified veterans to buy a house costing up to $203,000, in most cases with no downpayment and at below-market interest rates. Moreover, the qualification guidelines for VA loans are more flexible than criteria for either FHA or conventional loans. The VA application process is similar to any other type of mortgage loan, and many VA loans can be processed and closed without waiting for credit application approval. To determine whether you are eligible, check with your nearest VA regional office.

The Rural Housing Service, a branch of the U.S. Department of Agriculture, offers low-interest-rate mortgage loans with no downpayment requirements to low- and moderate-income borrowers who live in rural areas or small towns. The RHS also offers programs for home renovations and repairs. Check with your local RHS office or lender for eligibility requirements.

Graduated Payment Mortgage

The Graduated Payment Mortgage (GPM) is another alternative to adjustable-rate mortgages. Contrary to an ARM, GPMs have a fixed-note rate and payment schedule. However, GPM payments typically are set for only one year at a time. Each year for five years, the payments graduate at 7.5 percent to 12.5 percent of the previous year's payment. You may obtain a GPM in 30-year and 15-year repayment schedules.

Borrowers can maximize their purchasing power through the GPM's lower qualifying rate. GPMs also can be attractive in a market with rapid appreciation. In markets with moderate appreciation, a borrower who needs to move during the scheduled negative amortization period could face financial problems.

Information copied from http://www.car.org/aboutus/forconsumers/financing/

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