Your *First* *Steps* Toward Homeownership.

MORTGAGES FROM A TO Z

Getting Started

Many people don't even consider buying a home because they're afraid they can't afford it. But for most people, homeownership is within reach—especially with special programs for first-time homebuyers. In fact, for many, homeownership is as affordable as renting—in some cases even more affordable.

Know Your Finances

There's no substitute for being prepared, and that means having a real budget. Be honest. Be realistic. Know how much is coming in every month—and how much is going out. It will not only help you, but also help professionals, like your lender, do the best they can for you.

Choose a Lender Before You Shop for a Home

Mortgages are complicated financial transactions, but lenders are experienced in explaining the ins and outs of home loans to first-time homebuyers like you. Here's what a lender will do for you, in addition to lending you money:

- Help you determine just how much house you can afford
- Identify the different types of mortgages that meet your specific financial needs

What's more, if you choose your lender early in the process, you'll already have a strong working relationship when it actually comes time to apply for your mortgage.

There's nothing worse than falling in love with a house you can't afford—unless it's bypassing a house you could have afforded. That's why it's so important for you to have a good idea of how much house you can afford. Most people can't do that alone. If you work with a lender before you decide on a home, you'll know whether you qualify for a mortgage large enough to finance the home you want—and if you don't qualify, you'll know what steps to take to get you there in the near future.

Which Mortgage Is Right for You?

Okay, you've chosen a lender. You have your eye on a home. What type of mortgage should you get?

Not long ago, there was only one kind of mortgage: 30-year fixed-rate (the borrower has 30 years to pay back the mortgage, and the interest rate is fixed). While it is still the most common home loan, there are now several other kinds of mortgages that may better fit your situation.

Many different factors can, and should, influence your selection of a mortgage. As you read about the different mortgages that are generally available and discuss specific options with your lender, keep the following five factors in mind:

- Your current financial situation and resources
- How you expect your finances to change in the future
- How long you intend to keep the home you're buying
- How comfortable you might be with the idea of your mortgage payment changing from time to time
- How rapidly you want to build equity

Boulder Valley Credit Union

303-415-3505 or 1800-783-8850
mortgage@bvcu.org

Common Mortgage ChoiceS

Fixed-Rate Mortgages

With this type of mortgage, the interest rate is fixed for the entire term of the loan. Your monthly payments for interest and principal never change. Changes in property taxes and homeowners insurance, usually a part of your monthly payment, may increase or decrease, but generally your mortgage payment will be very stable.

Key Advantage: Predictability. Essentially, you know what your mortgage payments will be for the life of the mortgage.

Key Disadvantage: Higher interest rate (compared to initial rates of adjustable-rate mortgages).

Types of Fixed-Rate Mortgages

30-year fixed-rate mortgage: This very conventional loan offers the lowest monthly payments of any of the common fixed-rate loans.

Why this Loan: For people planning to remain in the home for many years and wishing to keep housing expenses consistent.

15-year fixed-rate mortgage: This loan has a shorter life—15 years. Because the loan is shorter, you'll pay less than half the total interest of a 30-year mortgage. However, because you repay the loan in half the time, the monthly payments are higher than those of a 30-year mortgage.

Why this Loan: For people who can afford the higher monthly payments, it allows you to own your home before your children start college or before you reach retirement.

Adjustable-Rate Mortgages

Adjustable-rate mortgages (ARMs) have an interest rate that changes at specified intervals. If interest rates go up during that time, so will your monthly mortgage payment. By the same token, if rates go down, your mortgage payment will also drop.

With an ARM, you and your lender share the potential risks of changes in interest rates. As a result, an ARM offers an initial interest rate that can be as much as two to three percent lower than a comparable fixed-rate mortgage.

Developed when interest rates were high, ARMs remain a good choice for those who expect their income to increase, who don't expect to be in their home for a long time, and generally when interest rates are relatively high. However, because the interest rate can increase, you must have the resources to keep up with possible changes in your mortgage payment.

Key Advantages: Lower initial interest rate compared to fixed-rate mortgages, which can make homeownership more affordable and make qualifying for a mortgage easier. If interest rates decline, your mortgage payments decline as well.

Key Disadvantages: The potential for higher monthly payments if interest rates increase.

A Little More about ARMs

There are four basic "ingredients" in all ARMs, and different mortgages combine them in different ways. While your lender can tell you more about the ARMs available in your area, here are some helpful definitions.

Initial interest rate: The benchmark for your loan, it can be one to three percent lower than a comparable fixed-rate mortgage.

Index: The economic indicator used to determine changes to your ARM's interest rate. Your loan is "tied" to this index. As that number rises and falls, so does your interest rate. An example of an index commonly used for ARMs is the yield on a one-year Treasury Bill (T-Bill); Boulder Valley Credit Union uses the one-year for our common index.

Margin: The percentage points the lender adds to the index to establish the actual interest rate of your ARM. The margin remains fixed.

Adjustment interval: The time between changes in your ARM's interest rate. If your ARM has an adjustment interval of three years, your rate—and your monthly payment—will be changed every three years, based on the current index plus your margin. Typical ARM adjustment intervals are one year, three years and five years.

In addition, an ARM may contain certain safeguards that limit the risk of sharply higher payments. One type of safeguard, called a periodic cap, limits the amount by which the interest rate can change at each adjustment. This may be combined with a limit on how much the rate can change over the life of the mortgage, called the lifetime cap.

For example, if your ARM has a periodic cap of two percent and a lifetime cap of five percent, your interest rate will not change by more than two percent at any single adjustment, and will never be more than five percent above your initial interest rate.

A payment cap is another type of safeguard that limits the increase in your monthly payment to a specific dollar amount (for example, $300). While this is more easily understood, it has a definite downside: it can prevent your monthly payment from increasing enough to match a rapidly increasing interest rate. If this happens, your payments will not be "keeping up" with the loan schedule (that is, you are neither reducing the principal nor paying the entire monthly interest figure). That could result in higher payments, more payments or a balloon payment later on.

Other Mortgage Options

Lenders have developed a number of other mortgages to assist you in reaching your goal.

Balloon mortgage: This offers relatively low, fixed payments similar to a standard 30-year fixed-rate mortgage, but after a few years—usually five to seven—the mortgage term ends with a single large payment (the "balloon"). At this time, you must make the balloon payment, sell the house or refinance. Because the term is actually quite short, the total interest paid is significantly less than a conventional mortgage, making this a good choice if you don't plan to stay in the home for very long. However, if the house does not appreciate, you run the risk of owing more money at the time of sale. In other words, by selling before the balloon comes due, the large lump sum payment is avoided.

Interest First: This offers a lower payment since only interest payments are collected instead of the traditional principal and interest. This also allows for more buying power. Restrictions will apply for this loan.

Stated Income: Specifically designed for the self-employed or commissioned borrower, stated income mortgages give you the ability to "state" your income, within reason, to qualify for the loan. Restrictions will apply for this loan.

What's Wrapped into Your Monthly Mortgage Payment

Principal and interest. That's the quick answer most people offer. But there's more than that in virtually every mortgage payment, no matter what type of loan you get.

Before we break out these other parts of your monthly mortgage payment, let's clearly define principal and interest.

Principal is the amount of money you borrowed. It begins, generally, as the sale price of the home you purchased minus the down payment you made. With every payment you make, this figure will decrease. In the case of a 30-year fixed-rate mortgage, a proportionally small amount of your payments the first few years goes toward reducing the amount of principal.

Interest is what you pay in order to borrow the money—it is "the cost" of money.

So, what are the parts of your mortgage payment that are not principal and interest? In most cases a portion is paid into a special escrow account, sometimes required by the lender and sometimes voluntary, that the lender maintains on your behalf to pay for things like homeowners insurance, property taxes and mortgage insurance. (This is the element of the monthly payment that can fluctuate even in a fixed-rate mortgage). Some people would rather pay their taxes and insurance themselves, putting money aside every month to do it and gaining interest for themselves on those funds.

Together, all the elements are commonly referred to as PITI (Principal-Interest-Taxes-Insurance). Currently, most states permit lenders to collect two months of estimated annual real estate taxes and insurance payments at the closing. Afterwards, your monthly payment will include one-twelfth of the annual total for taxes, insurance and other anticipated charges (your lender may collect an additional amount to ensure that a two-month cushion is maintained in the account). Your tax and insurance bills are then paid by the lender, creating less paperwork for you. However, some people do prefer to pay their taxes and insurance themselves.

Comparing Mortgages

The total cost of a mortgage involves more than just the interest payments you make. There may also origination fees, discount points and other miscellaneous costs.

What's more, there can be other terms and conditions that may affect the ultimate cost of your mortgage. When you compare different mortgages, be sure that you take into account all the factors that can influence your final costs.

Understanding Discount Points

What is a point? A point is equal to one percent of the total amount of a mortgage. That is, one point on a $100,000 mortgage is $1,000 (one percent of $100,000). Generally, you will pay all points at closing.

Most lenders offer mortgages with several combinations of points and interest rates. Generally, the lower the interest rate, the more points you will pay at settlement. (Interest rates affect your monthly mortgage payment, while the points affect the amount of cash you must have at the settlement.)

For example, if a loan with the current market interest rate has two points, a loan with an interest rate that's one-half percent higher than the market rate may have no points. Your choice among the various interest rate/points options will depend on how much cash you have available for the closing and settlement.

What interest rate will you pay?

As you discuss different mortgages with your lender, there are other conditions and terms that you should keep in mind. The most important of them is how and when the actual interest rate you will pay is determined.

Most lenders will quote a rate and fee at the time you apply for a loan, and then guarantee—or lock—the quote for a specified time. While this protects you from paying more for your mortgage if interest rates rise, it also means you will pay the quoted rate even if interest rates fall.

Lock periods usually run from 10 to 60 days. Longer periods are sometimes available for an additional fee. You will want your lock period to be long enough to get you through closing and settlement.

On some loan programs, Boulder Valley Credit Union automatically gives you an automatic float down at no additional cost. The rate can decrease between the time you apply and the time you close (within thirty days).

Contact your Boulder Valley Credit Union with questions concerning your mortgage needs.

Visit our Mortgage Loan Center at

www.bvcu.org

303-415-3505 or mortgage@bvcu.org

Boulder Valley Credit Union

Equal Housing Lender