Charting Your Course to Home Ownership

Unit 3
Sailing Through the Mortgage Process

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Navigating the Mortgage Process

Today's home mortgage market has a variety of choices. Many home buyers feel safest choosing a conventional, standard fixed-rate mortgage loan, but other types of loans can be more affordable or better suited to a buyer's personal situation. There are also special programs and loans to make home ownership possible for people who don't qualify for a conventional loan. Taking the time and effort to shop around and learn about available home finance options can save you thousands of dollars or make it possible to buy the home you want.

Understanding Mortgage Terms

The mortgage process has its own language. Don't let it frighten you away from finding the best suited mortgage loan for your particular needs. Here are some of the most important terms to understand.

For the typical mortgage loan, you must make a **down payment** to buy the property and borrow the rest of the purchase price. The other fees and expenses involved in getting and processing loans are called **closing costs**.

Lenders use **qualifying guidelines** to figure out the amount they will lend a buyer. A **qualifying ratio** of 28/36 means that: your monthly housing costs should total no more than 28% of your monthly gross (before tax) income, and your total long-term debt expenses (including housing and other debts) should total no more 36% of your monthly gross income. Simply stated, the larger the numbers in the ratio, the larger the loan you may qualify for.

Most loan decisions are made with an Automated Underwriting System (AUS), rather than a simple qualifying ratio. But it is a good idea to use the 28/36 ratio as a personal decision factor in what you can afford.

The minimum down payment needed is set by the **loan-to-value ratio (LTV).** For example, an 80% LTV means you can borrow no more than 80% of the appraised value of the property you want to buy. Higher LTV loans (to make a lower down payment) usually require you to buy mortgage insurance. **Mortgage insurance** protects the lender (not you) in case you don't pay the loan **(default).** The cost of mortgage insurance is usually added to the monthly mortgage payments and closing costs.

The **interest** (the fee for borrowing) you pay each month is based on the simple interest rate of the loan. The loan may also charge discount points, a form of interest paid up-front when the loan is made. Each point equals 1% of the loan amount. The annual percentage rate (**APR**) reflects the total cost of the loan, including simple interest, points and other fees.

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The monthly payments during the early years are mostly interest. In time, more of each payment is credited to paying down the debt (the **principal**). Gradually, as you pay off principal, you build up **equity** (ownership). This process of reducing debt through fixed payments of principal and interest (where the payment amount stays the same, but the part which applies to your debt gets larger over time) is called **amortization**.

In addition to principal and interest, monthly payments usually include an extra amount that is set aside by the lender (in escrow) to pay the borrower's property taxes and home owner's insurance. Lenders call this total amount **PITI** (principal, interest, taxes, and insurance).

The interest rate of a **fixed rate mortgage loan (FRM)** never changes, so the monthly payment (of principal and interest) stays the same for the full **term** (length) of the loan. The interest rate of an **adjustable rate mortgage loan (ARM)** can change (up or down) on the loan's adjustment dates. These changes are based on a financial **index** (such as the interest rate of one-year Treasury Securities). At adjustment times, the loan's interest rate is changed to a certain **margin** (added point spread) over the index rate. Typical margins vary from 1.25 to 2.5 percent points. It is wise to shop around for small margins.

In most **adjustable rate mortgages**, your initial interest rate (starting rate) is lower than for fixed rate mortgages because you are sharing the long-term risk (of higher interest rates) with the lender. Watch out for deeply discounted **initial "teaser" rates** (more than two percentage points less), which can rise sharply after the first year.

Today's ARMs generally offer some protection for the borrower by providing **interest rate caps**. A periodic or adjustment rate cap limits the amount the interest rate can increase at one time. A total or **lifetime cap** limits the total amount the interest rate can increase over the entire term of the loan.

In general, ARMs are more affordable in the beginning because they have lower interest rates than FRMs. The longer the time between rate adjustments, the higher the starting interest rate (but usually still lower than an FRM). All in all, the borrower pays more for interest rate stability. **The more stability, the higher the interest rate. The greater the risk to the borrower, the lower the starting interest rate.**

A summary of various loan programs and types of mortgage loans follows. Not all of these may be available to you. New types are continually being developed and offered. Still, this summary should be a handy reference to help you explore your options.

When making your way through the mortgage process, remember:

- Don't assume tomorrow's real estate market will behave like yesterday's.
- Don't count on rapid appreciation and inflation to make your home equity grow.
- The key is affordability – both now and later. Compare total loan and housing costs, including down payment requirements, monthly loan payments (now and at maximum levels), closing costs, moving expenses, utilities, maintenance and property taxes with expected income changes.
- Do your homework. Learn about home finance, the local real estate market and the home buying process before you begin.
- Shop around. Look into several sources of financing and types of mortgages.
- Subprime or non-prime loans exist to serve the needs of those with credit scores of 620 and below. Some prime lenders also offer subprime loans. **Subprime** (or nonprime) **loans** are more likely to have a prepayment penalty, high interest rates, higher fees and costs, and/or a balloon payment.
- Ask questions. Make sure you fully understand words, forms and what is happening.
- Watch out for sharks. Predatory lenders often lend money regardless of borrower's ability to repay. They may also pressure home owners to refinance their mortgage frequently.
- Don't assume you won't qualify for prime loans… check it out.
- A good defense is to keep your **credit history** clean, raise your **credit score**, shop around and compare.
- Negotiate. Better terms may be available than those first offered.
- Consider hiring a real estate attorney to help you understand the fine print.
- Study all available materials about mortgage costs. Institutional lenders are required to give you a statement of loan costs and terms before you sign.
- Don't assume anything. Don't be afraid to question anything that you are told.

LOAN PROGRAMS		
Loan Programs	**Description**	**Considerations**
Community Home Buyer's and other "Affordable Home Ownership" Programs	Programs targeting households with modest incomes and/or first-time home buyers. Various types of loans with flexible qualifying guidelines, low down payments and other forms of assistance. Widely available through private mortgage lenders, some may involve nonprofit organizations, state housing finance agencies, local government programs. Bond issues may make limited funds available for loans with below-market interest rates.	Designed to make home ownership possible. May allow nontraditional credit history, very flexible loan requirements. Usually requires home buyer education. Borrower may qualify for a loan size that is too large to manage comfortably, possibly resulting in default of loan. Bond-issue loans not always available; first come, first served.
Conventional	A mortgage that is not guaranteed nor insured by the federal government. Usually requires 20% down payment (80% LTV) unless private mortgage insurance is purchased to reduce it. Typical qualifying ratio is 28/36.	Typically requires more cash at closing than government program loans. Requires more income and less long-term debt to qualify. Loan processing time may be shorter. Larger loans possible. Widely available.
FHA (Federal Housing Administration)	FHA insures mortgage loans by approved lenders. May require only 3% to 5% down payment. Maximum loan limits based on local average housing costs. Higher (more affordable) qualifying ratios. Borrower pays mortgage insurance premium.	Easier to qualify for. Allows very low down payment and closing costs. Loan size may not exceed FHA limit for the area. Property must meet standards. May be assumable. Widely available. May provide some protections and alternatives to foreclosure for some delinquent borrowers.
Housing Finance Authority (HFA)	Typically offered by state agencies and often provide lower interest rates.	Total amount of funds are limited, therefore may not always be available. In most cases can not be combined with other bond issued programs.
U.S.D.A. Rural Development	Offers government guaranteed rural housing loans to moderate income buyers through private lenders and direct home ownership loans to low-income households in rural areas. No down payment, flexible qualifying guidelines, low interest rate, property standards.	Very attractive, affordable loan programs, but only for homes in defined rural areas and residents at or below income limits. Newly built homes must meet standards. Direct loans limited to very-low and low-income households available from local Rural Development offices. May require home buyer education.
Veterans Administration (VA)	Guaranteed by Veterans Administration, protects lenders against loss if payments are not made and is intended to encourage lenders to offer veterans more favorable terms.	Must have a Veteran's Certificate of Eligibility. No down payment is required in most cases. Loan maximum may be up to 100%. No PMI required. Limitations on buyers' closing costs. Variety of repayment plans.

TYPES OF LOANS		
Types of Loans	**Description**	**Considerations**
Adjustable-Rate Mortgage (ARM)	The borrower's interest rate fluctuates according to an index of interest rates based on changes in credit costs in the economy. ARM rates are usually 1 to 3 percent below conventional mortgage rates. Rate changes usually occur on an annual basis, but may be as often as monthly. Most ARMs have interest-rate caps that limit the amount by which the interest rate can increase.	Monthly payment can increase or decrease. Borrowers should consider worst case scenario under their contract and calculate the resulting monthly payment. "Teaser rates" may be offered to entice borrowers; beware the higher monthly rates that will occur when interest rates rise. Payment caps limit the amount by which the payment can vary. An ARM with a payment cap but without an equivalent interest-rate cap can result in negative amortization.
Assumable Mortgage	A mortgage that can be transferred to a new buyer when the home is sold.	Possibly lower monthly payments. May need second mortgage (at higher rate) to make up difference between down payment and equity; combination of loans should be analyzed to make sure it is more economical option. May be prohibited if "due on sale" clause is in original mortgage. Not permitted on most new fixed rate mortgages.
Balloon Mortgage	A type of fixed-rate mortgage loan in which the principal and interest payments are amortized over a longer period (perhaps 30 years) than the actual term (usually 7 years) of the mortgage. At the end of the term (when the balloon payment comes due), the outstanding balance must be paid with a lump sum payment or refinanced for the remaining period.	The option to refinance is not automatic and is conditional upon factors such as payment of closing costs, lender fees, and special assessments, and payment history. Generally, requalifying is not required to refinance unless there is a significant change in rate. Interest rate may be lower than comparable fixed rate mortgage. May be good for borrowers planning to sell or refinance within 7 years—provides relatively low payment during that time.
Buy-down	Developer (or third party) provides interest subsidy, which lowers monthly payments during a specified period of the loan.	Offers a break from higher payments during early years. Enables buyer with lower current income to qualify. Buyer must be prepared for payments to rise at end of subsidy. Developer may increase selling price to compensate for subsidy.

TYPES OF LOANS		
Types of Loans	**Description**	**Considerations**
Construction Loans	Short term loans meant to exist only during construction of home. Construction loans aren't meant to be a method of long-term financing.	Dispersed during construction, they are interest only on funds drawn at that time. At building completion, a mortgage loan is then secured.
Fixed Rate Mortgage (FRM)	FRMs are fixed-rate, fixed term, fixed payment mortgage loans. They are considered the granddaddy of all mortgages.	Neither the interest rate nor the monthly payment (principal and interest) ever change over the life of a FRM. Good for borrowers who place a high value on predictability. Interest rate may be 2-3 percentage points higher than initial rate on an adjustable rate mortgage. Higher initial interest rate means borrower must have a higher income to qualify. If interest rates drop, payments will remain the same unless the loan is refinanced and the borrower incurs costs of getting a new mortgage.
Home Equity Line of Credit (HELOC)	Typically a secondary loan, a HELOC is a type of loan that allows a home owner to tap into the equity of their home to obtain cash for other uses. A HELOC may also be called an equity line or an equity loan.	Because home was used to secure extra monies with a non-mortgage loan makes it crucial to get this paid promptly. Fewer steps involved in seizing home, in event of non-payment on loan.
Graduated-Payment Mortgage	Smaller-than-normal payments are required in the early years, but payments gradually increase to larger-than-normal payments in later years. Interest rate is fixed.	Low payments early in the life of the mortgage may be insufficient to pay interest, resulting in negative amortization. Attractive to buyers who expect substantial future income increases. Borrowers will pay more interest over the life of the mortgage than with fixed monthly payments.
Growing Equity Mortgage (GEM)	Designed to reduce interest costs by paying off the mortgage loan early. Bi-weekly mortgages are one form of GEM. Extra payments increase the total amount paid annually. Bi-weekly payments allow a 30 year mortgage to be repaid in about 20 years. Has fixed interest rate, often a few points below market.	Forces borrower to make the agreed-upon extra payments. Note that almost all lenders permit payment of additional amounts toward principal at any time as a way to get the loan paid faster and reduce interest charges. Borrower's income must be able to keep pace with payments. Equity increases faster.

TYPES OF LOANS		
Types of Loans	**Description**	**Considerations**
Interest-Only Mortgage	Borrower pays monthly payments on the interest on the mortgage for a fixed term. No monthly payment is made on the principal during this term, so the balance or debt remains the same. At the end of the term, usually 5 to 7 years, borrower can refinance, pay the balance in a lump sum, or begin paying off the principal with an increase in monthly payment.	Lower monthly payments may be attractive. Payments may increase significantly after the interest-only period. May be risky if you cannot afford higher payments in the future. Higher monthly payments may be avoided by refinancing—but no one knows what interest rates will be like in 3, 5 or 10 years. May incur prepayment penalties. Negative amortization may occur if housing prices stay the same or fall.
Land Contract	Seller retains original mortgage. No transfer of title until loan is fully paid. Equal monthly payments based on below-market interest rate with unpaid principal due at loan end.	Lower rate and payments, but may offer no equity until loan is fully paid. Buyer has few protections if conflict arises during loan.
Land Trust Mortgage	Loan to buy housing on leased land, typically owned by nonprofit organization seeking to create affordable housing opportunities.	Makes affordable housing possible. Not widely available. Home owner does not own land.
Lease-Purchase or Rent with Option to Buy	Renter may pay "option fee" for right to purchase property at specified time and agreed-upon price. Rent may or may not be applied to sales price. If provided by nonprofit organization, rent amount is sent to cover mortgage payments and an extra amount for savings for future down payment.	Enables renter to buy time to obtain down payment and decide whether to purchase. Locks in price during inflationary times. Failure to take options means loss of option fee and rental payments.
Piggy Back Loan **(also called two-tiered home loan)**	Designed to avoid paying private mortgage insurance (PMI) on loans with less than a 20% down payment.	Borrower secures two home loans — a primary mortgage for 80 percent of the purchase price, and a higher-rate secondary mortgage (the piggyback loan) for the rest of the borrowed amount. In some cases the combined monthly payment is less than one mortgage and PMI.
Reverse Annuity Mortgage (Home Equity Conversion)	Borrower owns mortgage-free property and needs income. Lender makes monthly payments to borrower, using property as collateral.	Can provide home owners with needed cash. At end of term, borrower must either have money available to repay, sell property or refinance. Usually most suitable to elderly with large equity but limited income.

TYPES OF LOANS		
Types of Loans	**Description**	**Considerations**
Rollover (Renegotiable Rate) Mortgages	Consists of a series of short-term loans for 2-5 year periods. Total amortization is spread over 25-30 years. The loan is renewed at the end of each time period at the prevailing market interest rate.	Monthly payments are fixed for 2-5 years and there is an agreement to refinance with the original lender.
Seller Financing	Seller agrees to accept all or a portion of the purchase price in installments, rather than as a lump sum. May be short-term arrangement with amortization over longer period with balloon payment due at designated time.	Buyer usually obtains title at closing. Safer than a land contract or contract for deed as title transfer occurs before all terms of contract are satisfied.
Seller Take-Back	Seller provides all or part of financing. Often done in combination with an assumed mortgage.	Some eager sellers may offer a below-market interest rate; no origination fees or points. May have a balloon payment requiring full payment in a few years or refinancing at market rates, which could increase debt.
Shared Appreciation Mortgage	Below-market interest rate and lower monthly payments in exchange for a share of profits when property is sold or on a specified date.	If home appreciates greatly, total cost of loan jumps. If home fails to appreciate, projected increase in value may still be due, requiring financing at possibly higher rates.
Wraparound	Seller keeps original low rate mortgage. Buyer makes payments to seller, who forwards a portion to the lender holding original mortgage. Offers lower effective interest rate on total transaction.	Lender may call in old mortgage and require higher rate. If buyer defaults, seller must take legal action to collect debt.

Adapted from: Reichel, C. (1998). Your Path to Home Ownership. Baton Rouge, La.; LSU AgCenter.

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LSU AgCenter Writing Team:
Jeanette A. Tucker, Ph.D., Professor
Deborah L Hurlbert, Extension Associate
Sheri Richard Fair, Extension Agent, Ascension Parish
Deborah C. Cross, Extension Agent, Iberville Parish
Cynthia C. Richard, Extension Agent, Calcasieu Parish
Cynthia B. Stephens, Extension Agent, Ouachita Parish

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Louisiana State University Agricultural Center
William B. Richardson, Chancellor
Louisiana Agricultural Experiment Station
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Louisiana Cooperative Extension Service
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Twenty Questions to Ask Before Choosing a Mortgage

To choose the best mortgage for yourself, you must know about the different types of mortgages. But, that's not all you need to know. You must also find the available options and evaluate each thoroughly. All mortgages of the same type are not exactly alike.

The Mortgage Search

Failing to comparison shop for your loan could be a costly mistake. Shop for interest rates. For example, the difference between a 6% and 7% interest rate on a $100,000 fixed rate mortgage costs $65.75 more per month and $23,670 over 30 years.

Another costly item is origination points. Each point equals to 1% of the loan, which will be charged at closing. Each additional point on a $100,000 loan will result in an additional $1,000. The larger the loan, the more such differences cost up front, but paying points can reduce your ongoing interest rate.

Mortgage Sources

Traditional home mortgage lenders – banks, credit unions, mortgage companies, online financial or mortgage companies and Rural Housing Service offices are the most common sources of mortgage loans. In addition, some financial companies and large corporations offer home loans. Special home ownership programs and loans may be available through local nonprofit organizations or government agencies.

Search Methods

Here are some ideas of how you might locate your mortgage options and narrow the list to a few you can analyze thoroughly:

- Some newspapers publish a weekly mortgage rate report in the real estate section. If all local lenders do not choose to participate, the list will not be complete. Still, it could help you follow rate trends, weed out some choices and give you a basis for comparison.
- It may be helpful to check any mortgage advertisements in newspapers and direct mail promotions. Ads should be interpreted carefully and not become the sole basis for your decision. They don't usually contain enough information to make fair comparisons.

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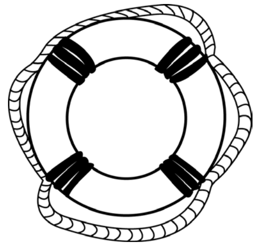


Life Saver
Conduct all mortgage inquiries within a 30 day period to count as only one inquiry on your credit score. Inquiries made over a longer period of time may impact your credit score.

- Local realtors are often an excellent source of current information about mortgage rates and terms. Most agencies survey all the major lenders in town every week or two as a service for their clients. Here again, the information they gather is probably not enough to make a final decision.
- Go online. Internet searches are a newer way to comparison shop for a mortgage loan. To find a reputable internet search engine, ask friends, family and co-workers for recommendations. A respected real estate agent is also a good source. Searching mortgage Web sites will likely reveal offers that appear to beat those of conventional "brick and mortar" lenders. However, this may not always be the case, as all offers also depend on your credit score. Next compare online offers of local lenders to provide an overview of rates in your area. By using information found through online comparisons, you may be able to negotiate a favorable rate locally or make an informed decision regarding on-line offers.

Remember, by spending a little time filling out forms, you can quickly come up with multiple offers to see if they offer more attractive deals.

Red Flag: When searching online, be watchful of sharing too much personal information.

Avoid mortgage search firms or realtors that charge a fee for helping you find a mortgage. Expect to pay commission to a realtor for representing you in buying or selling a house. You will also pay an origination fee to the lender for processing a loan application.

Red Flag: It is generally not a good idea to secure a loan from a lender that solicits you.

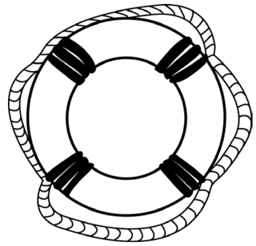
Mortgage Affordability

The maximum amount of your income that may be spent on your house note is set by the lender or the mortgage instrument. This is calculated to see how large a loan you may qualify for. **Keep in mind that qualifying for a certain loan amount does not always mean you can afford it. It is important to develop a household budget to see what monthly housing expenses you can really afford.**

It may be helpful to estimate monthly payments and affordability before you comparison shop. This is usually determined by two income ratios. For example, if the qualifying income ratios are 28/36, that means:

- your total monthly housing expense (principal, interest, taxes, insurance) cannot exceed 28% of your stable monthly income. This is called a **front-end ratio.**
- your total monthly debt payments (including this mortgage) cannot exceed 36% of your stable monthly income. This is called a **back-end ratio**.

For example, ratios would be calculated as follows for a family with a $48,000 annual pre-tax income, and $500 in monthly debt payments (car note and credit cards).



Life Saver
Contact at least five financial institutions for basic mortgage information and rates. For complete comparison, contact different types of lenders such as mortgage companies, banks, credit unions and online sources. Remember to ask each lender the same questions. Take notes so you can look over them later.

Front-End Ratio

Gross Monthly Income (pre-tax)	$4,000
X Housing Debt Qualifying Ratio	X .28
= Allowable Monthly House Payment (Principal, Interest, Taxes, & Insurance)	= $1120

Back-End Ratio

Gross Monthly Income (pre-tax)	$4,000
X Housing Debt Qualifying Ratio	X .36
= Maximum total Debt Allowed	= $1, 440
- Total Monthly Debt Payments	- $500 (car note and credit cards)
= Total allowable monthly house payment	= $940

Some lenders may offer special affordable loans or community home buyer programs with higher qualifying ratios (making the loan easier to qualify for) for first time or low- and moderate- income home buyers. Be sure to ask about these and whether or not you are eligible for them if such loans fit your needs and your budget.

It is also helpful to see how interest rates affect the monthly payment amount. You can check online or buy an inexpensive paperback book of amortization tables to look up monthly principal and interest payment amounts at various interest rates. If you can't find such a book, an estimate may be calculated from the following payment table:

Mortgage Payment Table
(Monthly payment for each $1,000 borrowed)

Interest rate	15 yrs.	20 yrs.	30 yrs.
4.5%	$7.65	$6.33	$5.07
5.0%	$7.91	$6.60	$5.37
5.5%	$8.17	$6.88	$5.68
6.0%	$8.44	$7.16	$6.00
6.5%	$8.71	$7.49	$6.32
7.0%	$8.99	$7.75	$6.65
7.5%	$9.27	$8.06	$6.99
8.0%	$9.56	$8.37	$7.34
8.5%	$9.85	$8.68	$7.69
9.0%	$10.15	$9.00	$8.05
9.5%	$10.45	$9.33	$8.41
10.0%	$10.75	$9.66	$8.78
10.5%	$11.06	$9.99	$9.15
11.0%	$11.37	$10.33	$9.53
11.5%	$11.69	$10.67	$9.91
12.0%	$12.01	$11.02	$10.29

Mortgage Analysis Tool

Once you finish your loan search, narrow your list to the two or three most appealing mortgages for a more thorough analysis. Call those lenders again for more details. Answers to the following list of questions are your tools for making a comparative mortgage analysis – the only way to make sure the loan is the best choice for you.

Questions for ALL Types of Mortgages:

❏ **1.** ***What qualifying ratios and guidelines apply to this type of loan?***

Red Flag: Be cautious. Getting the largest possible loan may be more than you can comfortably afford, even if you qualify for it.

❏ 2. ***Are there any restrictions and special requirements for this type of loan?*** If you are eligible for a loan with flexible qualifying guidelines, you may be able to borrow more (to get a higher-priced home) than with a conventional loan. Several types of loans have ratios of 29/41; others use a housing expense ratio of 33%.

Most types of nonconventional or specialized loans are available only to borrowers who meet certain criteria. Some have income limits, loan size limits, location restrictions, special property standards or other criteria. For any loan, ask about all qualifying guidelines (in addition to the qualifying ratio) such as cash reserve (how much cash you must have remaining after closing) and employment stability requirements.

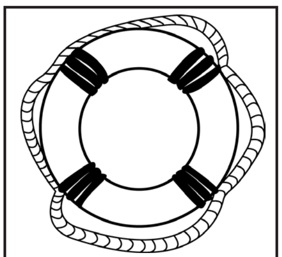
❏ 3. **What are the simple interest rate and discount points?** Discount points are a form of interest which is paid up front at closing. Each point equals 1% of the loan amount. Most lenders offer a choice of interest rates and discount points. The interest rate will be reduced for each point charged (roughly ¼% interest for 1 point, though the ratio varies).

As a general rule, the longer you plan to stay in your home, the greater the advantage of paying more points to get a lower interest rate. There may also be a tax advantage since points are tax deductible in the year paid. On the other hand, if you think you won't own that home very long, it's best to choose a loan with no points.

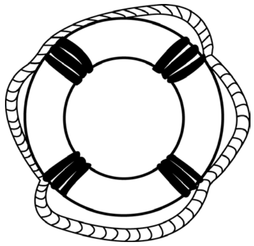
Red Flag: Beware of sub-prime loans that target buyers with lower than average credit scores. Higher APRs, that can add up to thousands of extra dollars, will be charged.

❏ 4. ***What is the annual percentage rate (APR)?*** The APR takes into account all the costs of financing – including the interest, origination fee, discount points, mortgage insurance, etc. – and amortizes them over the full term of the loan. This gives you an easy way to compare loan costs, if you keep that loan for its full term. If you don't intend to stay in the home that long, the APR becomes biased and is not the best basis for choosing the lowest cost loan.

❏ 5. ***Will you lock in the interest rate?*** The loan approval process usually takes from three to eight weeks, but can be longer if applications have backed up. If not locked in, the mortgage interest rate could change (upward or downward) before closing date.



Life Saver
Your APR will be higher than the interest rate of the mortgage. It includes all the costs of financing — including the interest, origination fee, discount points, mortgage insurance, etc.



Life Saver
When the ratio of your loan size to the current appraised value of your home drops below 80% you can save money by dropping your PMI.

Some lenders will lock in rates at no charge for 45-60 days; others may charge a fee to do so. Some allow you to lock in at any time during loan processing by telephone. This is helpful when market rates might fall.

❑ 6. ***What is the required down payment?*** Lenders will consider a number of factors in determining the down payment.

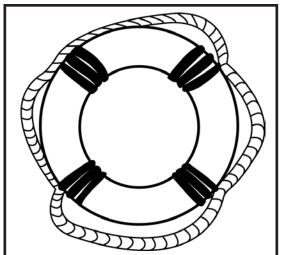
❑ 7. ***What would mortgage insurance cost?*** The down payment is determined by the loan-to-value ratio (LTV). For example, an 80% LTV translates a down payment of 20% of the home's appraised value. Private Mortgage Insurance (PMI) is required for any home with an LTV of less than 20%. It is purchased to protect the lender in case of default. Buying mortgage insurance and some special loan programs could reduce your down payments significantly.

PMI may require you to pay from two months to a first-year premium up front. After that, you typically pay monthly premiums until your loan balance (what you still owe) is reduced to 80% of your home's value.

For Federal Housing Administration (FHA) loans, you are charged a fixed insurance premium which will stay for the life of the loan and is called Mortgage Insurance Premium. Some special loan programs may have no premiums for eligible borrowers.

❑ 8. ***What is your loan application fee, and is it refundable?*** Most lenders charge a fee to cover the costs of an appraisal and credit report. The fee may not be refundable if the loan is not approved or if you decide against taking the loan.

❑ 9. ***What are the closing costs?*** Closing costs can total 2% to 8% of the loan amount (not including the down payment). Before you apply for a loan, most lenders can give you a good faith estimate—a form showing an estimate of closing costs for your potential loan. This estimate may include the origination fees (for making the loan), title charges and items which must be prepaid at closing. There may be other costs that are not listed on the form, however. Some fees may be negotiable or optional, and some of the fees may be paid by either the seller or buyer. So, ask the lender about all possible closing costs, in addition to what's on the standard form, developed by HUD. Lenders must also prepare and distribute with booklet a good faith estimate of settlement costs.



Life Saver
Lenders are required to provide all loan applicants a special information booklet, A Homebuyers Guide to Settlement Costs.

❑ 10. ***Are there any prepayment penalties?*** Penalties for paying off your mortgage early may be charged by your lender. Look for the terms "Prepayment Penalty" or "Early Termination Clause" in the mortgage documents. Knowing if your mortgage lender may charge this penalty is important if you may someday sell your home or if you might want to make extra payments to save interest. Be aware of differences in the penalties or clauses. "Hard" means the penalty will be charged no matter the circumstances under which the loan is prepaid, usually within the first five years. "Soft" means that if you sell the home to an unrelated or uninterested party, the prepayment penalty is waived.

Loans with prepayment penalties or early termination clauses may have lower finance costs. However, such a loan may be a good choice if you do not intend to prepay it or sell the home within the penalty period.

❑ 11. ***Is the loan assumable?*** An assumable loan can be passed on to the buyer of your home if you sell, provided it does not have a "due-on-sale" clause. It may or may not guarantee the same interest rate. Either way, the closing costs on an assumed loan are less than for a new loan. So that characteristic of a loan may help you sell your home. Assumable mortgages can make a property more desirable if interest rates have risen, because the new buyer's payments are at the original rate.

❑ 12. ***Is there a late payment charge?*** Most lenders charge a late payment fee, but they vary in how much and when the fee is charged.

Questions for Adjustable Rate Mortgages (ARMs):

❑ 13. ***Is the initial interest rate lower than that of a fixed rate loan?*** Some loans have very low initial interest rates ("teaser rates") to attract borrowers, and then rise.

❑ 14. ***If so, when and how will it change?*** Usually after one, three or five years the interest rate is raised to its normal level according to the loan agreement's formula.

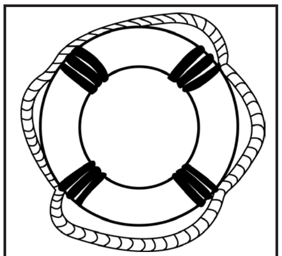
Unless you intend to have the mortgage for only a short time, it is better to make comparisons based on the formula interest rate rather than the initial rate. But if you plan to sell soon, the lower costs from that initial discounted interest rate could save you a lot of money.

❑ 15. ***How often can the interest rate and payment amount change?*** In general, the shorter the rate adjustment period, the lower the interest rate and vice versa. Frequent adjustments are better when rates are falling, but offer less protection when rates rise. Here again, the length of time you plan to own the home should affect your choice. For example, if you plan to buy a starter home and sell it soon to move up to a more expensive home, you might choose a 3-, 2- or even a 1-year ARM. The lower interest rate would save you money if you sell the home before the rates rise beyond the current rate of a fixed rate loan.

❑ 16. ***What adjustments index is used?*** Lenders and investors in adjustable rate mortgages utilize a variety of indexes including the performance or yield of 1 month, 1 year, 3 years and even 10 years of U.S. Treasury securities. Popular indexes include Prime Rate, Certificate of Deposit Index or Treasury Bills.

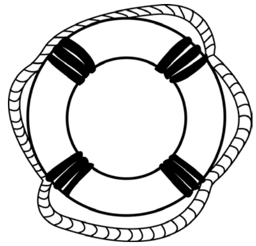
❑ 17. ***What is the margin?*** The interest rate of an ARM follows a published market index rate. A common one is the one-year U.S. Treasury Securities index. In general, indexes tied to long-term indicators (such as three-year securities) change less than those tied to short-term indicators (such as three-month Treasury bills). Long-term is better when rates are rising; short-term is better when rates are falling.

The margin, or point spread above the index, determines what your mortgage interest rate will be at each adjustment date. The smaller the margin, the closer your interest rate is to the index rate and the less you pay. Keep in mind that the same margin over two different indexes may produce two different interest rates.



Life Saver

It's a good idea to figure out (or ask the lender to give you) what would happen to the monthly payment amount of an ARM if: (a) rates rose to the upper limits of the caps (the worst case scenario) and (b) if rates dropped by 1% or 2%. This will give you a clear picture of the risk (and whether or not it will be affordable) if rates rise and the realistic opportunity for savings if rates fall.



Life Saver
When applying for a loan: if you are unsure of anything, STOP. Check it out, making sure you understand everything and that what is written on the application is what you were told. It is a legal contract and you are bound by it.

❏ **18.** ***Are there periodic and overall rate caps?*** Rate caps limit how much the interest rate can rise or fall at the adjustment dates and over the life of the loan. In general, the lower the rate caps, the smaller the risk to you – but the higher the starting interest rate. Most ARMs have 5% to 7% overall rate caps and 1% to 2% periodic rate caps.

❏ **19.** ***Is it convertible to a fixed rate mortgage?*** Some lenders offer ARMs which can be converted to a fixed rate mortgage (FRM) during a certain time period. Convertible ARMs usually have an interest rate which is lower than FRMs but higher than nonconvertible ARMs.

❏ **20.** ***Is negative amortization possible?*** If interest rates rise, payment caps (limit on the amount your monthly payments can change when the interest rate changes) can cause your debt to grow rather than shrink. Loans which allow your debt to grow (known as negative amortization) may put you as higher risk. Loans with payment caps can be structured with rate caps to avoid negative amortization.

Adapted from: Reichel, C. (1998). Your Path to Home Ownership. Baton Rouge, La. : LSU AgCenter.

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LSU AgCenter Writing Team:
Jeanette A. Tucker, Ph.D., Professor
Deborah L Hurlbert, Extension Associate
Sheri Richard Fair, Extension Agent, Ascension Parish
Deborah C. Cross, Extension Agent, Iberville Parish
Cynthia C. Richard, Extension Agent, Calcasieu Parish
Cynthia B. Stephens, Extension Agent, Ouachita Parish

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Louisiana State University Agricultural Center
William B. Richardson, Chancellor
Louisiana Agricultural Experiment Station
David Boethel, Vice Chancellor and Director
Louisiana Cooperative Extension Service
Paul D. Coreil, Vice Chancellor and Director
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Charting Your Course to Home Ownership

Comparing Mortgages Can Save You Money

You have probably heard the largest purchase you ever make is your home; however this is incorrect, your home mortgage will cost EVEN MORE! Comparison shopping and wise decision making will save you money. When shopping for a mortgage, use this comparison chart to examine differences in available mortgage options.

	Lender 1	
Name of Lender	*ABC Bank*	
Contact	*Amy*	
Date	*3/30/08*	
Mortgage Amount	*$100,000*	
	Mortgage 1	*Mortgage 2*
Basic Loan Information		
Type of Loan	*Fixed Rate*	*ARM*
Qualifying Ratios	*28/36*	*33/41*
Minimum down payment required	*3%*	*5%*
Interest Rate	*6.5%*	*4.50%*
Points	*2 ($2000)*	*1 ($1000)*
Length of loan	*30 years*	*30 years*
Requirements and Restrictions/Limits	*None*	*Up to $150,000*
Assumable?	*No*	*No*
Estimated monthly escrow for taxes and hazard insurance	*$200*	*$200*
Estimated monthly payment (principal, interest, taxes, PMI)	*$813*	*$710*
Fees (*Names of some fees may differ by lender)*		
Application fee or loan processing fee	*$250*	*$275*
Original fee or underwriting fee		
Lender fee	*$800*	*$780*
Document Preparation and recording fees	*$200*	*$200*
Appraisal fee	*$300*	*$300*
Attorney fees	*$400*	*$490*
Credit Report fee	*$18*	*$20*
Other fees:		
Late Payment Charge	*$35*	*$50*

LSU AgCenter Research & Extension

Other Costs at Closing/Settlement	Lender 1	Lender 2
Title Search/Title Insurance	$900	$875
Estimated prepaid amounts for interest, taxes, hazard insurance, payments to escrow		
State and local taxes, start up or transfer taxes		
Flood determination	$15	$18
Prepaid Private Mortgage Insurance (PMI)		
Termite Inspection	$60	$60
Surveys and home inspections	$225	$220
Total Fees and Other Closing/ Settlement Cost Estimates		
Additional Items to Consider		
Prepayment penalties		
Is there a prepayment penalty (early termination clause)?	Yes	Yes
If so, how much is it?	2%	5%
How long does the penalty period last? (1, 2, 3 ,4, 5 years)	2	5
Are extra principal payments allowed?	Yes	Yes
Lock-Ins		
Is the lock-in agreement in writing?	Yes	Yes
Is there a fee to lock-in?	No	Yes
When does the lock-in occur (at application, approval or another time)?	Application	Application
How long will the lock-in last?	30 days	30 days
If the rate drops before closing, can you lock-in at a lower rate?	No	No
Adjustable Rate Mortgage		
What is the initial rate?		4.5%
What is the maximum the rate could be next year?		+1%
What are the rate and payment caps each year and over the life of the loan?		+6%
What is the frequency of rate change and changes to the monthly payment?		Annual
What is the index that the lender will use?		1 yr Treasury
What margin will the lender add to the index?		2%
Credit Life Insurance		
Does the monthly amount quoted to you include a charge for credit life insurance?	No	No
If so, does the lender require credit life insurance as a condition of the loan?		
How much does the credit life insurance cost?		

Mortgage Comparison Chart				
	Lender 1		Lender 2	
Name of Lender				
Contact				
Date				
Mortgage Amount				
	Mortgage 1	Mortgage 2	Mortgage 1	Mortgage 2
Basic Loan Information				
Type of Loan				
Qualifying Ratios				
Minimum down payment required				
Interest Rate				
Points				
Length of loan				
Requirements and Restrictions/Limits				
Assumable?				
Estimated monthly escrow for taxes and hazard insurance				
Estimated monthly payment (principal, interest, taxes, PMI)				
Fees *(Names for some fees may differ by lender.)* Typical fees are listed below.				
Application fee or loan processing fee				
Original fee or underwriting fee				
Lender fee				
Document Preparation and recording fees				
Appraisal fee				
Attorney fees				
Credit Report fee				
Other fees:				
Late Payment Charge				
Other Costs at Closing/Settlement				
Title Search/Title Insurance				
Estimated prepaid amounts for interest, taxes, hazard insurance, payments to escrow				
State and local taxes, start up or transfer taxes				
Flood determination				
Prepaid Private Mortgage Insurance (PMI)				
Termite Inspection				
Surveys and home inspections				
Total Fees and Other Closing/Settlement Cost Estimates				

Additional Items to Consider				
Prepayment penalties				
Is there a prepayment penalty (early termination clause)?				
If so, how much is it?				
How long does the penalty period last? (1, 2, 3 ,4, 5 years)				
Are extra principal payments allowed?				
Lock-Ins				
Is the lock-in agreement in writing?				
Is there a fee to lock-in?				
When does the lock-in occur (at application, approval or another time)?				
How long will the lock-in last?				
If the rate drops before closing, can you lock-in at a lower rate?				
Adjustable Rate Mortgage				
What is the initial rate?				
What is the maximum the rate could be next year?				
What are the rate and payment caps each year and over the life of the loan?				
What is the frequency of rate change and changes to the monthly payment?				
What is the index that the lender will use?				
What margin will the lender add to the index?				
Credit Life Insurance				
Does the monthly amount quoted to you include a charge for credit life insurance?				
If so, does the lender require credit life insurance as a condition of the loan?				
How much does the credit life insurance cost?				

Adapted from: Reichel, C. (1998). Your Path to Home Ownership. Baton Rouge, La.; LSU AgCenter.

Additional References:
Freddie Mac. (n.d.). Buying and Owning a Home: Mortgage Shopping Worksheet. Retrieved on April 10, 2008 from http://www.freddiemac.com/corporate/buyown/english/pdf/mortgage_shopping_worksheet.pdf

LSU AgCenter Writing Team:
Jeanette A. Tucker, Ph.D., Professor
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Charting Your Course to Home Ownership

Applying for a Mortgage Loan

It is usually best to apply for a loan after you have a signed purchase agreement on the home you want to buy. However, it is possible to apply for "pre-approval" of a specified loan amount before then. This can be helpful when the buyer or seller is in a hurry to close the sale. But, since the pre-approval is generally good for only three months and the application fee is non-refundable, you could have to pay the fee again and repeat the process if the pre-approval expires before you buy a home.

Either way, when you have found the kind of mortgage you want with the best terms for your situation, it's time to make an appointment with the lender. You may want to request that a loan application be mailed to you and ask what you should bring with you to the interview.

The Loan Interview

It is important to prepare for the loan interview. Try to anticipate everything you will need and have all of the necessary information with you (including names, addresses with zip codes, phone numbers, dates of employment, etc.)

If you and a co-purchaser will both sign the mortgage, you should both go to the loan interview.

Loan Application Checklist

This checklist will help you prepare your loan application. It includes most of the information you will need to supply. However, some lenders have slightly different requirements, so check with your lender to ensure you collect all the required information.

Identification:

- Social Security number
- Driver's license or state-issued photo ID

Address History:

- Current address, name and address of landlord, and current monthly rent
- Previous address/landlord information if you've lived at current address for less than two years

Proof of Income:

- Employer information (names, addresses and phone numbers) for past two years

- Recent pay stub showing year-to-date earnings
- Original W-2 forms for previous two (2) years
- Copies of tax returns for previous two years
- Proof of additional income (Social Security, interest income, alimony or child support, etc.)

Self-employed borrowers:

- Personal, partnership or corporation tax returns for the previous two years
- Current financial statements for the business

Assets:

- Recent statements for checking, savings, and brokerage accounts and CDs
- Statements for all retirement accounts (401(k), IRA, etc.) and non-retirement investments (stocks, bonds, mutual funds, etc.)
- Cash value of any life insurance policy
- Value of significant personal property, such as vehicles and boats that are paid in full

Liabilities:

- Statements (showing name of creditor, outstanding balance and monthly payment) for auto loans, student loans, credit cards, and other debts, including loans you have cosigned
- Alimony or child support you must pay

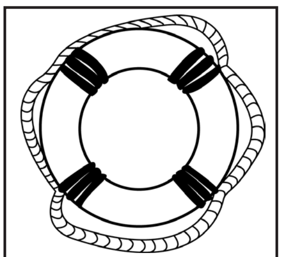
  NOTE: If you don't have an established credit history, provide the lender with canceled checks for rent, utilities and other financial obligations as proof of consistent payments.

Purchase Information:

- Copy of the home purchase contract
- Proof of your deposit
- A "gift letter" if the money for your down payment is a gift that doesn't have to be repaid

Payment:

- A check to cover the cost of the application, credit report, appraisal and other fees



Life Saver
Most loan decisions are made with an Automated Underwriting System (AUS), rather than a simple qualifying ratio.

Qualification

If you have not already been prequalified by this lender, the loan officer will first want to make sure you qualify for the loan you are applying for. Be sure to ask the lender about loan requirements and restrictions if you are eligible for any of the special affordable loan programs with flexible qualifying guidelines.

The Loan Application

If you have not already done so, the lender can help you fill out the loan application. This form is designed to provide the information the lender needs to evaluate the risk involved in lending money to you (the likelihood that you will or won't repay the loan). You will not help yourself by trying to cover up past credit problems in hopes that the lender won't discover them. Be completely truthful, but don't try to show why past problems are behind you.

Once you have signed the loan application, you may be bound to accept the loan if it's offered or to pay the lender's processing costs if your application is rejected. Be sure the application states amounts and terms that are acceptable to you. Don't sign if you are unsure about ANYTHING. When in doubt, check it out.

At this time, you may be required to pay an application fee, which should cover the cost of the appraisal and credit report only.

Locking in the Current Rate

If you think interest rates might rise during the time the loan is being processed, the lender may agree to lock in the current rate (and number of points) for a certain period. Find out when the lock-in takes effect and how long it remains in effect, and get the lock-in agreement in writing. A lock-in for a very short period may be useless; you want something that will get you to closing without having to be extended.

Estimates of Closing Costs

Within three days after you have applied for a home loan, the lender is required to give you an itemized estimate of the costs to settle (or close) the loan. This report is referred to as a "good faith estimate." The lender must also give you a copy of the government publication, *A Home Buyer's Guide to Settlement Costs*. Read it!

Items included in the good faith estimate document:

- **Appraisal** –The lender will arrange to have the property appraised, a service for which you will probably be charged as part of the loan application fee. The lender's professional appraiser will determine the market value of the home. This is important because the loan amount cannot be larger than a given percentage of the value of the property. The amount of mortgage insurance you need to buy (if any) is also based on the market value of the home.

  If the appraised value is less than the purchase price, the amount of your mortgage may be smaller than you had planned, and you could have to come up with a larger down payment. On the other hand, if you have included an appraisal contingency in your contract, you can renegotiate the purchase price or back out of the deal if the appraisal is low.
- **Loan Application Origination** or **Processing Fee** – This charge covers the expenses of preparing mortgage documents, legal service, borrower credit investigation, notary charges, appraisal fee and any other fees.
- **Title Search and Title Insurance** – Title Insurance is usually paid by the seller because he or she guarantees the title to be good. The buyer usually pays for the mortgagee title policy. This protects the lender against unrecorded title defects.
- **Abstract of Title** – Summary of all recorded documents affecting a particular piece of real estate to document a clear and marketable title.
- **Survey** – The survey determines the precise legal boundary lines of a property, location of improvements, easements, right of ways, encroachments and other physical features. Sometimes, the seller may incur this expense if he or she is requested to do so.

- **Deed Recording Fee** – Charged by parish clerk of court's office to legally record your deed.
- **Attorney's Fee** – This fee is charged by the attorney for legal advice during the various stages of buying.
- **Unpaid Special Assessments** – Any assessment for streets, sidewalks, sewers, etc. that are levied or pending against the property before closing usually must be paid if mortgage financing is obtained.
- **(Discount) Points** – A point is one percent of the mortgage value. Thus, the borrower who must pay one point on a $100,000 mortgage would pay $1000, up front. Discount points are interest paid up front. They can be negotiable depending on the loan product.
- **Prepaid Property Taxes** – At the time of closing, the lender will often require the buyer to deposit one to six months' property taxes in an escrow account.

Truth in Lending

Your lender is also required to give you a Truth In Lending document, which fully discloses all the terms and conditions of the loan. Some of the terms required to be disclosed include:

- Rate of Interest – This is the largest single determinant of the cost of your loan. Be watchful, a lender could promise a lower-than-market interest rate because the difference may be made up through other financing charges.
- Annual Percentage Rate (APR) – The APR is the cost of your loan expressed as a yearly percentage rate, such as 5 percent or 6 percent. In the Truth In Lending disclosure you will notice the APR may differ from what your loan officer disclosed to you. This is because the APR includes all fees and costs associated with the loan.

It is normal to see a slight difference between the interest rate and the APR because of the normal costs of the loan. Some lenders may take advantage of people by offering a competitive interest rate and adding extra fees after the normal costs of a loan. This increases the disclosed APR of the loan. **If the APR is extremely different from the original quoted interest rate, do not be afraid to question this.**

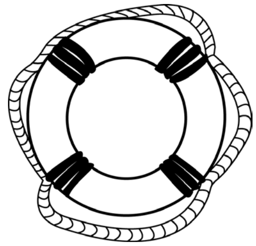
Speeding the Approval Process

Be sure to act quickly in the lender's request for information while your loan is being processed. It's also a good idea to call the lender now and then to check on the status of your application. You can then contact your employer or others who must provide documents or other information to the lender before your loan can be approved.

Loan Processing

In processing your loan application, the lender will mainly be interested in two things:

- the property you plan to buy (since it is collateral for the loan), and
- your financial situation and your credit history (since they will show your ability and your commitment to repay the loan).



Life Saver
Save money by cancelling mortgage insurance (PMI) when you have accrued equity equal to 20% of the amount of your mortgage.)

To get information about these, the lender will arrange for an appraisal of the property, request credit reports on you and any co-borrowers, and verify the information in your loan application.

Credit Report

The lender also will order a credit report on you, your spouse and any other co-purchasers. The charge for this is usually included in your application fee. The credit bureau's report will show how you have handled past debt and credit accounts, such as car loans, charge accounts with stores, credit cards and any other purchases made on credit. If you have already seen your credit profile; there will be no surprises.

When there is little or nothing on your credit report, you may be able to establish a nontraditional credit history by providing evidence that shows you are a dependable credit risk. Ask your lender for suggestions of what types of evidence you could provide to show your credit worthiness.

It is unusual for the lender to ask for a written explanation of any problems that appear on your credit report (although it is best to clear them up before applying for your mortgage). Even one late payment on just one account usually requires an explanation. Don't be alarmed by this request. Just respond promptly with a truthful statement about whatever caused the late payment(s).

Lenders are also likely to order your credit score. This tool helps lenders decide whether to offer you credit and at what term, such as interest rate and loan size.

Verifications

The lender will also verify (check to confirm) the information on your loan application about your income and employment history, your assets (checking and savings accounts, etc.) and your rent payment history.

Approval of Mortgage Insurer

If your down payment will total less than 20% of the appraised value of the home you want to buy, you will probably need to purchase mortgage insurance. In general, the borrower pays a mortgage insurance premium to buy insurance that protects the lender in case the borrower defaults. Mortgage insurance can make it possible for you to make a down payment of only 5% (sometimes less in special programs).

If mortgage insurance is needed, the loan will also have to be approved by the mortgage insurer. If you are obtaining an FHA, VA or USDA Rural Development loan, the loan and property must also meet FHA, VA or USDA Rural Development standards and restrictions.

Commitment Letter

When your loan is approved, the lender will **send you a commitment letter**. This is the formal loan offer. It will **state the loan amount** (purchase price minus down payment), **the term** (number of years you have to repay the loan), the loan **origination fee** (a percentage of the loan amount), the points (up front finance charge), the annual percentage rate or **APR** (the actual finance charge taking into account the interest rate, origination fees, points and mortgage insurance fees) and the **monthly charges** (principal and interest, property taxes and insurance or PITI).

You will be given a set amount of time to accept the loan offer and to close the loan. Go over the commitment letter before you sign it. Be certain you understand and will be able to meet any conditions set by the lender. By signing the commitment letter, you accept the terms and conditions of the loan offer.

Loan Denial

If your loan application is not approved, find out why. You may be able to correct the situations that led to the denial or try to find a lender with different or flexible approval requirements. One rejection does not mean all lenders will reject your loan application. Lenders are required to explain in writing a decision to deny credit. Go back and talk with the loan officer to find out details about the reasons. Some reasons may be corrected quickly (such as renegotiating the price on a home with a low appraisal), but others may require long-term solutions (such as a poor credit history).

You then have at least four options: work to correct the problem, apply for a different mortgage, appeal the decision or postpone buying a home until your situation has improved. Here are some common reasons for loan denial and ideas to consider when planning your course of action:

Low appraisal

- Renegotiate the purchase price with the seller.
- Ask the seller to correct problems which affected the appraisal or set up an escrow account to pay for repairs after the sale.
- Buy a different home.

Not enough income

- Find or wait for a loan with a lower interest rate (such as an ARM or bond-issue loan).
- Find an affordable loan program with flexible qualifying guidelines.
- Choose a less expensive home to buy.
- Get a co-signer.
- Think about ways your family can increase your household income.
- Reapply later when your income is higher.

Unstable income

- Ask your employer to send a letter verifying that your income will be stable in the future (if that is the case).
- Seek a stable source of income for someone in your household.

Too much debt

- Work out a repayment plan, and send the lender a letter explaining your debt reduction plan.
- Choose a less expensive home to buy.
- Find an affordable loan program with flexible qualifying guidelines or lower interest rate.

- Get a co-signer.
- Reapply later after you have reduced your debt.

Problems on credit report

- Get a free copy of your credit report from http://.www.annualcreditreport.com
- Check it for accuracy; challenge and correct any errors you find.
- Ask the credit bureau to add to your file your written explanation of any unresolved disputes.
- Send a brief statement to the bureau to explain late payments caused by loss of job or medical bills.
- Contact your creditors, set up a repayment plan and make whatever size payments you can to show good faith.
- Contact a nonprofit credit counseling service.
- Seek family financial management information and education from your parish extension office of the LSU AgCenter.

Not enough saving for down payment and closing costs

- Ask relatives to help.
- Buy private mortgage insurance.
- Look into FHA, VA, USDA Rural Development and other affordable loan programs which require little or no down payment.
- Seek a lease-purchase arrangement (rent with option to buy).
- Postpone buying a home, and develop a budget and savings plan to reach your financial requirements.

Disqualified property (Government-assisted loan programs may have property standards or restrictions for homes financed.)

- Choose a different home to buy.
- Find a loan program that does not have property restrictions.
- Negotiate with the seller to bring the property up to standards.

Adapted from: Reichel, C. (1998). Your Path to Home Ownership. Baton Rouge, La.; LSU AgCenter.

Additional References:
Hernandez, Ivan. Mi Propia Casa (Home of my own): Loan Application Process. http://nmhomeofmyown.com 3/18/2008

LSU AgCenter Writing Team:
Jeanette A. Tucker, Ph.D., Professor
Deborah L Hurlbert, Extension Associate
Sheri Richard Fair, Extension Agent, Ascension Parish
Deborah C. Cross, Extension Agent, Iberville Parish
Cynthia C. Richard, Extension Agent, Calcasieu Parish
Cynthia B. Stephens, Extension Agent, Ouachita Parish

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Louisiana State University Agricultural Center
William B. Richardson, Chancellor
Louisiana Agricultural Experiment Station
David Boethel, Vice Chancellor and Director
Louisiana Cooperative Extension Service
Paul D. Coreil, Vice Chancellor and Director
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Charting Your Course to Home Ownership

Understanding Subprime Lending

Subprime lending provides loans to consumers with less-than-perfect credit histories. **Not all sub-prime loans are predatory** (charge excessive interest and fees or use deceptive practices). However, many predatory lenders market their services to people who are financially distressed and are, therefore, classified as subprime. Until a few years ago, many subprime borrowers probably would not have even qualified for loans or credit cards. Today, however, they are aggressively extended credit, but at a higher cost.

Prime or Subprime?

Subprime borrowers include people from all ages, occupations, ethnic groups and income levels. Most have credit blemishes including:

- Late payments
- Judgments and wage garnishments
- Bankruptcy and foreclosures
- High debt-to-income ratio

In addition to those with credit blemishes, some subprime borrowers simply lack a credit history. They are "invisible" to lenders because there is no information in their credit file. Many subprime borrowers, can qualify for better loan terms (because they have a prime credit score), but they don't know it.

Lenders also generally use a credit tier scale to rate borrowers. Commonly used credit tier ratings are:

A—All bills paid on time

B—At least one bill paid by as much as 30 days late

C—One or more bills overdue for 30 to 90 days

D—At least one bill sent to a collection agency or written off

About 70% of borrowers have "A"(prime) credit scores and 30% are subprime with ratings of A-, B, C, or D.

Credit scores (a mathematical gauge of creditworthiness based on one's credit history) are also considered in the determination of prime and subprime borrowers. The exact threshold for an "A' (prime) borrower differs among lenders.

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Prime or Subprime—What's the cost difference?

Subprime loan rates can range from only 1-2% to over 10% higher than the cost of a conventional loan, depending upon a lender's rates and the borrower's credit history.

Over time, the difference in interest rates and monthly payments between prime and subprime loans can be thousands of dollars, especially for long loans. The difference in prime and subprime interest rates for a $100,000, 30-year, fixed rate mortgage loan in March 2008 is given in Table 1.

Credit Score	Interest Rate	Monthly Payment	Total Interest Paid
620-674 (Prime)	7.761	$717	$158182
561-619 (Subprime)	13.802	$1,169	$320,918

Table 1. (Source: **http://www.myfico.com/myfico/CreditCentral/LoanRates.asp#Calculator***)*

Avoid Subprime Loans

Subprime borrowing is costly and should be avoided if possible. Try these tips to avoid subprime loans.

- **Replace subprime loans as credit improves.** After a year of making on-time payments, apply for a prime rate loan to replace a high-cost loan.
- **Check your credit report before borrowing.** Credit reports may contain errors. For example, information from people with similar names can get co-mingled. If another person's information is negative, it can cause a borrower to be incorrectly classified as subprime.
- **Check your credit score.** Some lenders will tell you your credit score on request. Otherwise, order your credit score from one or more of the three major credit reporting agencies. They may be ordered online from http://www.equifax.com, http://www.transunion.com or http://www.experian.com .
- **Try to borrow from a bank or credit union.** As many as 10-15% of persons who assume they are subprime may actually qualify for a prime rate loan. They won't know, however, unless they apply. Even if they are classified as subprime, they will pay a much lower interest rate at a bank or credit union than at a "fringe banking" company.
- **Avoid finance companies.** They generally charge higher rates for consumer loans than banks and credit unions, often more than 20 percent. Additionally, finance company loans recorded in a credit report can decrease a borrower's credit score, thereby keeping him or her classified as subprime.

Additional References:

• Fair Isaac. (n.d.). Loan Savings Calculator. Retrieved March 30, 2008 from http://www.myfico.com/myfico/CreditCentral/LoanRates.asp#Calculator

• O'Neill, B. (2001). "Predatory Lending Practices and Subprime Credit: What Financial Counselors and Educators Need to Know. In J. Hogarth, (Ed.), Proceedings of the Association for Financial Counseling and Planning Education (pp.143-153). New Brunswick, New Jersey: Rutgers Cooperative Extension Service.

• O'Neill, B., Beaugard, C., Brennan, P. and Young, M. (2002). Predatory Lending Practices and Credit Rip-Off (Second Edition). New Brunswick, New Jersey: Rutgers Cooperative Extension Service.

LSU AgCenter Writing Team:
Jeanette A. Tucker, Ph.D., Professor
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Charting Your Course to Home Ownership

The Closing: What You Should Know

The closing is when you legally buy the property. It is usually a formal meeting attended by the buyer, seller, listing agent, selling agent and closing agent. Depending on local practice, the closing agent could be your attorney, your lender, the title insurance company agent or other real estate professional.

Preparing for Closing

Before closing day, there will be tasks you must complete. There are also several things you should do to avoid delays and problems. Your "To Do" list may include:

- Be sure your closing date falls within your lender's commitment period so your interest rate lock-in (if there is one) stays in effect through your closing date.
- Give your present landlord enough notice (usually 30 days). If you are moving out before your lease expires, check it to see if it requires you to pay out the rest of the lease term and if you can recover your deposit without any penalties.
- Make sure the title search is done as early as possible (in case there is a title problem that needs to be cleared up before closing).
- Order your home owner's insurance policy, and send the policy to your closing agent before the closing day.
- Do a final walk-through to inspect the house one more time as near the date of your closing as possible to make sure everything is the way you expect it to be. The walk-through is your chance to question any previously agreed-upon repairs that have not been made, any new damage and the removal of anything that was supposed to stay in the home. (Of course, your purchase agreement should clearly state this.) You can then postpone the closing until the problems are fixed by the seller or negotiate a new agreement in time.

If the home is new construction, you may want to sign off on a document, often called a punchlist, with the contractor to identify any remaining minor items which may need to be completed after the closing. It's a good idea to hold back some money from the contractor in the escrow account until all agreed punch list items are completed. If major work remains to be done, you should postpone your closing.

- Make sure the seller will be out of the house before your closing date, but avoid leaving the house empty too long. If the seller can't move out in

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time, it may be wiser to postpone the closing date rather than rent to the seller after you take ownership.

- Check with your lender a week before closing to find out exactly how much money you will need for closing costs, to whom checks should be made out and what types of checks are needed.

On the day of closing, be sure to have:

- The right time, date and place of the closing and correct spelling of your closing agent's firm.
- Any receipts for closing-related expenses you have already paid, such as your deposit on the house, mortgage application fees, inspection fees and home owner's insurance policy or binder.
- Enough money for all the closing costs in certified checks or money orders as specified by your lender or closing agent.

The Closing Documents

The main activity in a closing is reading and signing papers. You will be asked to sign legal documents that record your promise to repay your loan and give the lender rights to the house if you default.

Although the closing agent can help you understand the documents you must sign, you may want an attorney to read the documents with you and represent your interests. You will be asked to sign several documents and affidavits. Here are some of the most important documents you will see:

HUD-1 Settlement Statement

This form, which is required by federal law, itemizes the lender's loan related services and lists the charges to the buyer and the seller. It is filled out by the closing agent. Both the buyer and seller must sign it. One business day before settlement (closing), buyers have the right to inspect the HUD-1 Settlement Statement. It's a good idea to compare the fees you will actually pay with those agreed to earlier (especially if you negotiate any fee reductions or waivers).

The Note

The mortgage note is your promise to pay the lender according to the agreed terms, including monthly payment amount, payment due dates and where payments should be sent.

The note also states the penalty fees that will be charged if you are late with your payments and warns you the lender can call the loan (require full payment before the end of the loan term) if you fall behind on your payments or if you otherwise violate the terms of your note or mortgage.

The Mortgage

The mortgage (or deed of trust) secures the note, giving the lender a claim against your house if you default on the note's terms. You have ownership of the property, but the lender has the right to reclaim it upon default until the loan has been paid in full.

The mortgage restates the basic information contained in the note and the date of the final scheduled payment. It typically requires the borrower to:

- pay the principal, interest, taxes and insurance in a timely manner;
- maintain hazard insurance on the property without lapse; and
- maintain the property and not allow it to deteriorate.

If you do not comply with all these requirements, you are in default and the mortgage allows the lender to demand full payment of the loan balance immediately, foreclose on the property, sell it and use the proceeds to pay off the loan and costs of the foreclosure.

Affidavits

You may be asked to sign several affidavits (oaths) required by state law or the lender. For example, you may need to sign an oath that you plan to live in the property you are buying. If you give false information, you can face criminal penalties and your lender might demand immediate full payment of the loan.

Cash Sale

The cash sale transfers ownership from the seller to you. It is prepared and recorded by the title company.

Closing Costs

The closing costs are the fees charged by the mortgage lender and other service providers such as: the mortgage origination fees, credit report fees, discount points, lender's attorney's fees, document preparation fees, land survey, appraisal, hazard insurance escrow account. Most of these costs are usually paid by the buyer, but the local customs vary. Not every lender charges for every item. It's possible to have an agreement where the seller pays some or all of the closing costs.

Review the Good Faith Estimate prepared for your mortgage loan. You may be able to reduce your costs through negotiating and by shopping around for lower cost sources of closing services such as legal representation, title insurance, hazard insurance and inspections.

The following table gives a rough estimate of closing costs for a $180,000 mortgage. It does not include taxes and government fees, escrow and prepaid items. This is only an estimate, and your closing costs will probably be different from these. In most cases, closing costs range from 3% to 8% of the loan amount (not including the down payment).

Closing costs averages comparison: Louisiana		
Item	**Louisiana**	**U.S. Average**
Origination fees		
Loan amount	$180,000	$180,000
Points	0.454%	0.485%
Points ($)	$816	$874
Administration fee	$200	$237
Application fee	$282	$284
Commitment fee	--	$425
Document preparation	$204	$206
Funding fee	$188	$181
Mortgage broker, origination or lender fees	$794	$853
Processing	$398	$369
Tax service	$76	$69
Underwriting	$343	$303
Wire transfer	$25	$24
Title and closing fees		
Appraisal	$318	$327
Attorney, closing or settlement fee	$396	$426
Credit report	$20	$20
Flood certification	$15	$14
Pest, other inspection	$60	$62
Postage / courier	$42	$45
Survey	$204	$234
Title insurance	$854	$756
Title work: Title search, plat drawing, name search, endorsements	$190	$167
Total average fees	**$2,851**	**$2,748**

Note: The figures displayed above were collected in 2005, prior to Hurricanes Katrina and Rita.

Adapted from: Reichel, C. (1998). Your Path to Home Ownership. Baton Rouge, La.; LSU AgCenter.

Additional References:
Bankrate.com.research (2008). Closing costs averages comparison: Louisiana. Retrieved March 28, 2008 from http://www.bankrate.com/brm/news/mortgages/cclouisiana.asp

LSU AgCenter Writing Team:
Jeanette A. Tucker, Ph.D., Professor
Deborah L Hurlbert, Extension Associate
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A. **Settlement Statement**

U.S. Department of Housing and Urban Development

OMB Approval No. 2502-0265 (expires 11/30/2009)

B. Type of Loan

1. ☐ FHA 2. ☐ FmHA 3. ☐ Conv. Unins. 4. ☐ VA 5. ☐ Conv. Ins.	6. File Number:	7. Loan Number:	8. Mortgage Insurance Case Number:

C. Note: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals.

D. Name & Address of Borrower:	E. Name & Address of Seller:	F. Name & Address of Lender:

G. Property Location:	H. Settlement Agent:	
	Place of Settlement:	I. Settlement Date:

J. Summary of Borrower's Transaction		**K. Summary of Seller's Transaction**	
100. Gross Amount Due From Borrower		**400. Gross Amount Due To Seller**	
101. Contract sales price		401. Contract sales price	
102. Personal property		402. Personal property	
103. Settlement charges to borrower (line 1400)		403.	
104.		404.	
105.		405.	
Adjustments for items paid by seller in advance		**Adjustments for items paid by seller in advance**	
106. City/town taxes to		406. City/town taxes to	
107. County taxes to		407. County taxes to	
108. Assessments to		408. Assessments to	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
120. Gross Amount Due From Borrower		**420. Gross Amount Due To Seller**	
200. Amounts Paid By Or In Behalf Of Borrower		**500. Reductions In Amount Due To Seller**	
201. Deposit or earnest money		501. Excess deposit (see instructions)	
202. Principal amount of new loan(s)		502. Settlement charges to seller (line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208.		508.	
209.		509.	
Adjustments for items unpaid by seller		**Adjustments for items unpaid by seller**	
210. City/town taxes to		510. City/town taxes to	
211. County taxes to		511. County taxes to	
212. Assessments to		512. Assessments to	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
220. Total Paid By/For Borrower		**520. Total Reduction Amount Due Seller**	
300. Cash At Settlement From/To Borrower		**600. Cash At Settlement To/From Seller**	
301. Gross Amount due from borrower (line 120)		601. Gross amount due to seller (line 420)	
302. Less amounts paid by/for borrower (line 220)	( )	602. Less reductions in amt. due seller (line 520)	( )
303. Cash ☐ From ☐ To Borrower		**603. Cash ☐ To ☐ From Seller**	

Section 5 of the Real Estate Settlement Procedures Act (RESPA) requires the following: • HUD must develop a Special Information Booklet to help persons borrowing money to finance the purchase of residential real estate to better understand the nature and costs of real estate settlement services; • Each lender must provide the booklet to all applicants from whom it receives or for whom it prepares a written application to borrow money to finance the purchase of residential real estate; • Lenders must prepare and distribute with the Booklet a Good Faith Estimate of the settlement costs that the borrower is likely to incur in connection with the settlement. These disclosures are manadatory.

Section 4(a) of RESPA mandates that HUD develop and prescribe this standard form to be used at the time of loan settlement to provide full disclosure of all charges imposed upon the borrower and seller. These are third party disclosures that are designed to provide the borrower with pertinent information during the settlement process in order to be a better shopper.

The Public Reporting Burden for this collection of information is estimated to average one hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

The information requested does not lend itself to confidentiality.

L. Settlement Charges		
700. Total Sales/Broker's Commission based on price $ @ % =	Paid From Borrowers Funds at Settlement	Paid From Seller's Funds at Settlement
Division of Commission (line 700) as follows:		
701. $ to		
702. $ to		
703. Commission paid at Settlement		
704.		
800. Items Payable In Connection With Loan		
801. Loan Origination Fee %		
802. Loan Discount %		
803. Appraisal Fee to		
804. Credit Report to		
805. Lender's Inspection Fee		
806. Mortgage Insurance Application Fee to		
807. Assumption Fee		
808.		
809.		
810.		
811.		
900. Items Required By Lender To Be Paid In Advance		
901. Interest from to @$ /day		
902. Mortgage Insurance Premium for months to		
903. Hazard Insurance Premium for years to		
904. years to		
905.		
1000. Reserves Deposited With Lender		
1001. Hazard insurance months@$ per month		
1002. Mortgage insurance months@$ per month		
1003. City property taxes months@$ per month		
1004. County property taxes months@$ per month		
1005. Annual assessments months@$ per month		
1006. months@$ per month		
1007. months@$ per month		
1008. months@$ per month		
1100. Title Charges		
1101. Settlement or closing fee to		
1102. Abstract or title search to		
1103. Title examination to		
1104. Title insurance binder to		
1105. Document preparation to		
1106. Notary fees to		
1107. Attorney's fees to		
(includes above items numbers:)		
1108. Title insurance to		
(includes above items numbers:)		
1109. Lender's coverage $		
1110. Owner's coverage $		
1111.		
1112.		
1113.		
1200. Government Recording and Transfer Charges		
1201. Recording fees: Deed $; Mortgage $; Releases $		
1202. City/county tax/stamps: Deed $; Mortgage $		
1203. State tax/stamps: Deed $; Mortgage $		
1204.		
1205.		
1300. Additional Settlement Charges		
1301. Survey to		
1302. Pest inspection to		
1303.		
1304.		
1305.		
1400. Total Settlement Charges (enter on lines 103, Section J and 502, Section K)		

The Undersigned Acknowledges Receipt of this Disclosure Statement and Agrees to the Correctness Thereof.

______________________________ ______________________________

______________________________ ______________________________

Buyer or Agent **Seller or Agent**