Learn 15 Frequently Asked Mortgage Questions

Description

Understanding the answers to these questions can make the mortgage application process much less complicated. Most first-time homebuyers will need to secure a mortgage, which may be a frightening procedure.

Nevertheless, armed with a bit of knowledge about what you'll need and what to expect from the mortgage application process to the closing table, you may put those anxieties to rest. With this in mind, we've answered 15 of the most often-asked mortgage questions.

1. Do I have to have perfect credit to receive a mortgage?

Not required, but it will undoubtedly assist. A typical mortgage can be obtained with a FICO credit score as low as 620, while a higher-cost FHA mortgage can be obtained with a score in the 500s. However, keep in mind that the worse your credit score, the higher your interest rate.

A current list of mortgage rates broken down by credit score can be found here. The differencebetween a 620 credit score and an “excellent” 760 credit score on a $250,000 mortgage adds up tomore than $86,000 in interest savings over the life of a 30-year loan.

2. How much money do I need for a down payment?

The quick answer is that a standard mortgage can be obtained with as little as 3% down, an FHA loan with 3.5% down, and a VA or USDA loan with no money down at all. If your down payment is less than 20% of the home’s sale price, you’ll have to pay private mortgage insurance, or PMI, with a conventional or FHA loan.

But those payments will not be a permanent fixture in your monthly payments. You can ask your lender to drop them whenever your loan-to-value ratio falls below 80%. Even if you do not request it, lenders are required to terminate PMI when the loan-to-value ratio falls below 78%.)

3. What are closing fees, and how much should I budget for them?

The term “closing costs” refers to all of the fees you must pay before your loan is finalized. Origination fees, title insurance, prepayment escrows, and other costs may be included. Closing expenses can vary greatly, but on average, anticipate paying 2% to 3% of the home’s purchase price in closing charges.

4. Should I choose a fixed-rate mortgage or an adjustable-rate mortgage?

A fixed-rate mortgage makes good financial sense when interest rates are historically low, as they are now. Not surprisingly, the great majority of new mortgages are fixed-rate. Adjustable-rate loans are chosen by just approximately 3% of buyers.

While a fixed-rate mortgage is the best option for the vast majority of homebuyers, an ARM may be preferable in some cases. For example, if you plan to sell your home before the fixed interest period ends and the interest rate begins to fluctuate, an ARM might save you thousands of dollars. Alternatively, during periods of dropping interest rates, an ARM might provide you with a cheap initial rate while saving you money later if rates fall more.

5. Should my interest rate be “locked”?

A rate lock guarantees you today’s mortgage interest rate for a set period of time, often 30 to 60 days. If interest rates are rising, it’s usually a brilliant idea to lock in your rate. While the current mortgage rate is unlikely to change significantly in a month or two, it is certainly possible.

6. Which mortgage is best for me?

There are various sorts of mortgages to pick from. A conventional mortgage is more challenging to qualify for in terms of credit, but an FHA loan can be more expensive. If you are a veteran, a VA loan may be the best option for you, and if you want to buy a property in a rural region, a USDA mortgage may be the best option for you.

7. What are discount points, and do I need to pay them?

Discount points are funds paid in advance on your mortgage in exchange for a cheaper interest rate. One “point” is equal to 1% of the loan amount. Therefore, one discount point would be $2,000 on a $200,000 mortgage. Discount points are tax-deductible, and if the interest savings over the life of the loan exceed the points paid, it may be worthwhile.

By evaluating the effect of different interest rates on your mortgage, a mortgage calculator can help you assess whether discount points are a good option.

8. Should I seek a term loan for 15 or 30 years?

This is determined by how far you want to push your budget. A 15-year mortgage typically has a lower interest rate than a 30-year mortgage if you can afford the higher monthly payments. You will not only pay off the mortgage faster, but you will also save a significant amount of interest. A 30-year mortgage, on the other hand, will cost less per month, allowing you to purchase a more significant or fancier house or one in a better location.

9. What documents should I collect?

Your lender may request a variety of documents, but in general, be prepared to present all of the following:

• Income verification (tax returns from the previous two years, W-2s, 1099s, and your most recent pay stubs)

• Driver’s license and Social Security card (or alternative ID)

• Evidence of funds to close (and, if not explicit, an explanation of where they came from)

• If some or all of your down payment is a gift, you will need a gift letter from the source of the funds confirming that it is a gift and not a loan.

10. What exactly is pre-qualification?

A pre-qualification is a simple evaluation of your financial situation to see if you qualify for a mortgage.

A pre-qualification is not a firm assurance of a loan because it is based on unverified information you submit and does not involve a credit check or any documents.

11. What exactly is pre-approval?

A pre-approval, as opposed to a pre-qualification, can be a very beneficial tool in the home-buying process. It’s essentially the same as applying for a mortgage but without the requirement of a specific residence.

A lender will analyze your credit, verify your income and employment, and agree to grant a set amount of money as part of a pre-approval. A pre-approval letter can demonstrate to sellers that you’re serious about purchasing a home and that you’ll be able to follow through on an offer and close on their property.

12. What exactly is an escrow account?

When you get a mortgage, you’ll usually be requested to put money into an escrow account to guarantee the lender that the continuing expenditures of owning the home, notably taxes and insurance, will be taken care of. You’ll deposit a significant sum into the escrow account (also known as your “prepaid”) at closing and then add to it with each of your monthly mortgage payments.

13. Why is it so difficult to close a mortgage?

Mortgages typically take at least 30 days to process, and many first-time buyers do not anticipate such a long wait. The short answer is that a lot of things must happen between the time you submit your mortgage application and the time you take ownership of your house.

Here are a few examples: You’ll need to gather documents for your lender (and they’ll always want for more, believe me); arrange and complete a home inspection; the seller may require time to finish repairs, and the loan must go through underwriting.

It’s a time-consuming process. I’ve purchased three homes in my life, and I can tell you directly that there’s a lot to do, even within a 30-day span.

14. How is my mortgage payment calculated?

Depending on your circumstances, your mortgage payment will typically consist of three or four components:

• Principal: Your outstanding balance is repaid.

• Interest: The payment of interest on the outstanding balance.

• Taxes: See also question 12. One-twelfth of your annual property taxes will be deducted from your mortgage payment and paid into your escrow account.

• Insurance: This covers homeowner’s insurance as well as any other hazard insurance required by law, such as flood or windstorm insurance. If you put less than 20% down on your loan, you may be required to pay private mortgage insurance. Your mortgage payments are commonly referred to as PITI because they are based on these four items.

15. Will my monthly payments alter during the length of the loan?

Probably. Even if you have a fixed-rate loan, your payment is likely to fluctuate over time. What’s the reason? The escrow component of your payment is based on your property taxes and insurance bills, which fluctuate. If they rise, your lender may need to request a bigger escrow payment.

Category

1. Finance

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