Definitions and Explanations:

(Obtained from the Mortgage Alliance Corp."Home Buyer's Handbook")

Rate Shopping

Shopping for the best interest rate possible has always been the consumer's primary objective when borrowing money. As well it should be! The challenge with this strategy is that there is much misleading information released on the subject by various media. Internet websites and email marketing, along with other media such as radio, television and billboard advertising, have brought the importance of interest rates to the forefront of consumers' minds.

The problem for the consumer with this type of marketing is that it is designed to make the lender's phone ring. Often, the advertiser offers a ridiculously low interest rate, with the intent of using a "bait-and-switch" technique once the client is reeled in. This is often done through short pricing. Short pricing is a term that is used when a lender offers an extremely attractive interest rate, but that rate is only locked in for a very brief period of time.

The average consumer enters into a purchase contract to buy a home for at least 30 days. Pricing on an interest rate locking in for a 7-day period is of no use to most prospective home buyers. It simply isn't enough time to complete the transaction. While the billboard advertising or internet banner ad may boast a terrific rate, the lock-in period is often not realistic in terms of providing enough time to negotiate a purchase contract and close the deal. Be very careful when shopping for interest rates. Make sure that when you are quoted a rate, you are asking the broker what the lock duration is. Make sure that lock period allows you enough time to complete your purchase transaction.

The Contract

The process of purchasing a home is often much more complex that the average individual expects it to be. Items involved in your purchase contract can have a significant impact not only on the success of your purchase transaction, but on your stress level as well. We have listed out some of the important items you should be aware of, that require you to make decisions as a buyer entering into a purchase contract.

Loan or Financing Contingency

Loan Contingency is the period of time the seller is giving you to obtain full, formal loan approval. It is important to include a financing contingency in your offer, as it makes the transaction dependent on you receiving the mortgage you've applied for. It specifies your cancellation rights if you are unable to obtain financing.

This contingency is typically between 15 and 30 days depending on what has been negotiated in the contract. The earnest money deposit you make at the time the offer is accepted will be put in jeopardy once the contingency for the loan has expired. In fact, pursuant to the terms of the contract, if the loan contingency has expired and you fail to close the purchase transaction; you could lose your earnest money deposit and not have the failure of obtaining loan approval to lean on as an excuse. Written pre-approval will help to eliminate problems in this area. Please note: pre-approval is not the same as pre-qualification.

Pre-Approval

Seeking pre-approval for financing prior to making an offer on a property is a sound strategy that can help you get the best deal possible, especially if you plan to make a minimal down payment. The seller is often leery of the stability and reliability of the buyer if the buyer is only capable of making a down payment of 10% or less. This can cause the buyer to lose a significant amount of negotiating ability, by being perceived as a weak buyer rather than a strong one. This is why it is very important to get full loan credit approval in advance and provide a written confirmation of the loan approval when an offer is made. This shows it is a d one deal and you are perceived to be a cash buyer.

Seller Contributions

Depending on the seller's eagerness to close the transaction, the seller of a property will often become aggressive and offer to pay some or all of the closing costs, origination points and/or pre-paid items (interest, hazard insurance, tax escrows) associated with the purchase on the buyer's behalf. This common strategy can be very beneficial to the buyer, particularly if the buyer is short on funds to close. It can also be the vehicle that effectively drives the interest rate down and provides the buyer with a more affordable monthly payment.
Note that there are limitations on how much the seller is permitted to contribute, depending on the loan-to-value ratio. The typical limitation stipulated by the lender is that the seller contributes no more than 9% of the purchase price, based on the size of the down payment. Seller contributions may sometimes be isolated to non-recurring closing costs and/or origination points only. The lender will not permit the seller to contribute funds back to the seller after the close of the transaction to accommodate repairs to the property. Items such as roof leakage or new carpet cannot be covered by a seller contribution clause.

Origination points

Origination points are often misunderstood. Points are nothing other than interest paid at the time of closing to obtain a lower interest rate on a loan. One point is equivalent to 1% of the loan amount. If you are going to borrow $300,000 on your loan, one point would equal $3,000. This generally generates 1/8 to 3/8 of a percent lower interest rate, depending upon the loan program.
When does it make sense to pay points? Paying points is a prudent financial move, if you are planning to be in the loan for a long period of time. Again, one of the most important questions to address when you borrow money is, "How long do you need to borrow this money?" This will answer the two all-prevailing questions you will have, which are 1) should I pay points? And 2) what loan program is best for me? Notice that the question is not geared to, "How long do I plan to live in the home?" but more appropriately, "How long am I likely to be in this loan?"
How long you will be in the loan is not only affected by the tenure that you own the home, but also the probability of seeking a refinance at some point in the future. As a general rule of thumb, you will need to be able to recuperate the total cost of the points in a period of time that is less than the amount of time you will need to borrow the money. Here's an example. Let's say you are going to borrow $300,000 for your mortgage, and choose to pay one point, which equates to an initial upfront cost of $3,000. If paying one point up front saves you $100 a month, this means it will take you 30 months or 2.5 years, to recuperate the cost of the point that you paid. If you refinance the home anytime before that 30-month mark, or decide to sell the home, you will have effectively wasted money. However, if you keep that loan for longer than a 30-month period of time, it is a prudent financial move.
When deciding whether or not you should pay points, take into consideration where interest rates are at when you seek financing, and compare that to historical market trends.

Credit Scoring

Your credit score is a major factor that will be considered by the lender when they review your loan application. The want to know what your credit history is, and whether you have the ability to pay back the loan you are requesting. In short, good credit translates into lower rates for the home buyer and less risk to the lender.
Credit scores can range between a low score of 300 and a high of 850. The higher the client's score is, the less likely they are to default on their loan. We will run a credit

report to determine what your credit score is, and if necessary, we can point out some simple ways to help you improve your credit score without enlisting the help of a credit repair service.
Once you fill out a loan application and enter into the loan process, you should not run up your charge cards or make any major purchases! You also should not apply for any other type of new credit, as this could negatively impact your credit scores.
Today, many programs limit your borrowing ability if you have a low credit score. If you do have a low credit score you may still be able to obtain financing, just be prepared for both a higher interest rate and higher down payment requirements. While you may not get the interest rate you had hoped for, it is an opportunity to start building up your credit again. Once you begin making mortgage payments on time and in full, your credit standing will improve and we can seek to refinance you at a lower rate as soon as the opportunity arises.

Pre-Payment Penalties
Lenders attach pre-payment penalties to loans to ensure that the loan will be profitable for them. As a general rule of thumb, we do not suggest that you accept a pre-payment penalty as a part of your loan structure. One of the most important aspects of financial planning is to have options with your money. Restrictive clauses such as a pre-payment penalty can prohibit you from maneuvering when it is necessary or when other opportunities arise.
If you want to accept a pre-payment penalty clause in your loan, it is much more advisable to go with a "soft pre-pay." This only penalizes you in the event of a refinance, but not if you decide to sell the home.
Interest rates have dropped significantly many times over the last 15 years. Many homeowners have not been able to take advantage of lowered rates by refinancing, because their hands have been tied by a daunting pre-payment penalty. Pre-payment penalties will generally provide you with a slightly lower interest rate in exchange for the pre-payment penalty clause. Mortgage professionals will sometimes push the benefits of a pre-payment penalty so they can beef up their commission. Be very leery of this type of sales pitch!

Junk Fees
A junk fee is a derogatory term defining extra fees, which are charged as a dollar figure rather than a percentage of the loan amount. It is important to know that you can often negotiate these fees down or have them removed if they have not been properly disclosed to you. The lender is required to provide you with a Good Faith Estimate disclosing their fees within three days of your application.

Glossary of Terms
Adjustable Rate Mortgage (ARM)
A mortgage in which the interest rate is adjusted periodically based on a per-selected index and margin, also referred to as the renegotiable rate mortgage.
Amortization
Means of loan payment by equal periodic payments calculated to pay off the debt at the end of a fixed period, including accrued interest on the outstanding balance.

Annual Percentage Rate (APR)
The interest rate that reflects the cost of a mortgage as a yearly rate. This rate is likely to be higher than the stated note rate or advertised rate on the mortgage, because it takes into account points and other credit costs. The APR allows home buyers to compare different types of mortgages based on the annual cost for each loan, however not all lenders calculate APR the same way.

Broker
This person assists in arranging funding or negotiating contracts for a client. Brokers usually charge a fee or receive a commission for their services.

Buydown
This is when the lender and/or home builder subsidizes the mortgage by lowering the interest rate during the first few years of the loan. While the payments are initially low, they increase when the subsidy expires.

Construction Loan
This is a short-term interim loan for financing the cost of construction. The lender advances funds to the builder at periodic intervals as the work progresses.

Earnest Money or Escrow Deposit
Money given by a buyer to a seller as part of the purchase price to bind a transaction or assure payment.

FHA Loan
A loan insured by the Federal Housing Administration open to all qualified home purchasers. While there are limits to the size of FHA loans, they are generous enough to handle moderately-priced homes almost anywhere in the country.

FHA Mortgage Insurance
All types of Mortgage insurance protect the lender in the event of default. There are two types of FHA Mortgage Insurance – Up-Front Mortgage Insurance (MIP), paid at closing and Monthly Mortgage Insurance, paid monthly with the mortgage payment. Upfront premiums range from 1.25% to 2.25% of the loan amount and monthly premiums range from 0.50% to 0.55%, depending on the borrower's credit score and the loan-to-value.

Escrow Amount
That portion of a borrower's monthly payments held by the lender or servicer to pay for taxes, hazard insurance, mortgage insurance, lease payments, and other items as they become due. Also know as reserves.

Mortgage Insurance (MI)
Money paid to insure the mortgage when the down payment is less than 20%. See Private Mortgage Insurance or FHA Mortgage Insurance.

Origination Fee
The fee charged by a lender to prepare loan documents, make credit checks, inspect and appraise a property; usually computed as a percentage of the loan amount.

PITI
Also known as total monthly housing expense, this is an acronym for the principal, interest, taxes, and insurance.

Private Mortgage Insurance
In the event that you do not have a 20% down payment, the lender may allow a smaller down payment, sometimes as low as 3%. However, with a smaller down payment, borrowers are usually required to carry private mortgage insurance on the loan. Private

mortgage insurance comes in two forms: upfront, paid at closing, and monthly. A lender may require some combination of both upfront and monthly mortgage insurance. The amount required is determined based on program type, property type, credit score and loan-to-value.

Underwriting

Approves (or declines) funding to potential home buyers, based upon factors such as credit, employment, assets, etc., and matches approved risks with appropriate rates, terms and loan amounts.

VA Loan

VA Loans are mortgage loans that are available to eligible US Veterans. VA guaranteed loans are made by private lenders, such as banks or mortgage companies, for the purchase of a home for a buyer's own personal occupancy. These loans offer competitive rates and require little or no down payment.