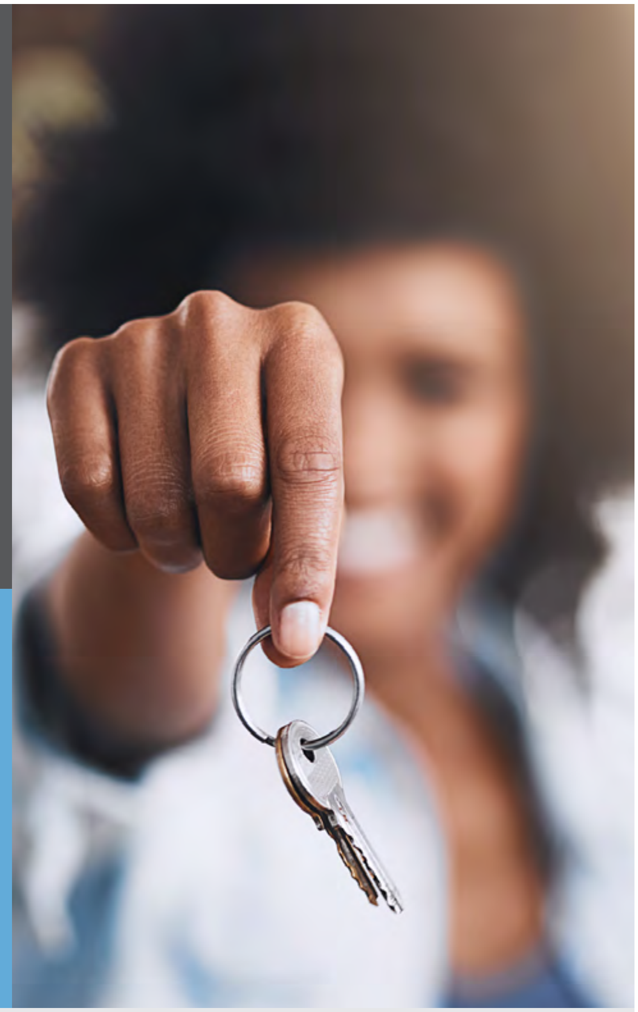
Homebuyer's guide to financing



Helpful information you need to know

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Understanding the basics

What exactly is a mortgage?

It's a loan secured by real estate. You get one when you borrow money to buy a home and promise to pay it back over a specified period, for a specified cost. Repayment typically happens through monthly mortgage payments. If you stop repaying the loan, your lender may take ownership of the property.

What does my mortgage payment include?

Primarily, principal and interest. If your down payment is less than 20% of the home's purchase price, however, your mortgage payment may include principal, interest and mortgage insurance. In addition, you'll be required to make monthly payments of your homeowners insurance, property taxes and association dues to be placed in an escrow account, along with any other required expenses that may apply. Your lender will then pay those third parties from the escrow account funds.

- The principal part of your payment reduces the original amount you borrowed.
- The interest part covers the fee to borrow the amount you still owe.
- The taxes and homeowners insurance parts are collected and held in an escrow account to pay your property tax and homeowners insurance on your behalf as they come due. If mortgage insurance is applicable to your loan, that part of your payment is forwarded to the agency that is providing the insurance.

Note: Use of an escrow account to pay for taxes and insurance is an option, as long as you have at least 20% for down payment. If you choose this option, or you have less than a 20% down payment, your monthly payment to your lender will include property tax and homeowners insurance.

Understanding the basics *(continued)*

What does "amortize" mean?

Bankers use this term to refer to the process of paying off a debt by regularly scheduled payments that include both principal and interest. In the early stages of your mortgage term, your mortgage payment is mostly interest and only a small portion pays down your principal. As you continue making payments through the years, and because the principal balance is reduced, a smaller portion of each payment is interest and a larger portion of your payment goes toward reducing principal until your entire loan is repaid.

What is homeowners insurance?

It provides financial protection in the event of losses resulting from fire, wind, natural disasters or other hazards. Most mortgage lenders require you to have a homeowners insurance policy.

What is mortgage insurance?

Mortgage insurance (MI) protects the lender against financial loss if a customer fails to repay the loan. It is usually required when your down payment is less than 20% of the home's purchase price.

- FHA-insured loans require a mortgage insurance premium (MIP)
- VA loans require a funding fee
- Conventional loans can be insured with private mortgage insurance (PMI)

What are closing costs?

In addition to the sales price of the home, you'll need to pay for the services of various real estate and lending-related professionals who are required to complete a purchase transaction. Depending on your lender, the mortgage you chose, and the location of the home, these "closing costs" can add up to thousands of dollars. You'll get a better idea of the amount soon after you apply for the loan.

Understanding the basics *(continued)*

What other costs should be considered?

While homeowners don't have to pay rent, they do have to manage expenses — beyond mortgage payments — that renters never face.

Maintenance

Keeping a property in top condition can be costly. This is particularly true of older homes, where system and appliance warranties may have expired. Home warranty plans provide repair or replacement coverage for certain built-in appliances and major home systems for a specific length of time. They cost a few hundred dollars a year, depending on the size of your mortgage and where you live.

Taxes

Most communities finance schools and other services through property taxes. Tax rates vary from town to town, so ask your real estate agent about taxes in your area. The good news is, whether you pay them directly or through the tax portion of your mortgage payment, property taxes are usually fully deductible at income tax time. Consult your tax advisor for details.

Association dues

Condominiums and planned unit developments (PUDs) often have homeowners associations that can charge fees as high as several hundred dollars a month. These may be included as part of your mortgage payment. If not, you'll need to budget for them.

How much money can I borrow to buy a home?

Your lender can help you get a preapproval that helps you understand the amount that you may be able to borrow. Add your preapproved maximum loan amount to the amount you plan to use for your down payment, and you will know your home purchase price range.

Understanding the basics *(continued)*

How do lenders determine if a customer qualifies for a mortgage?

Lenders look at your credit score, the cash you have available for a down payment and closing costs, your income, and your existing debt and financial obligations among other things in comparison to their lending guidelines.

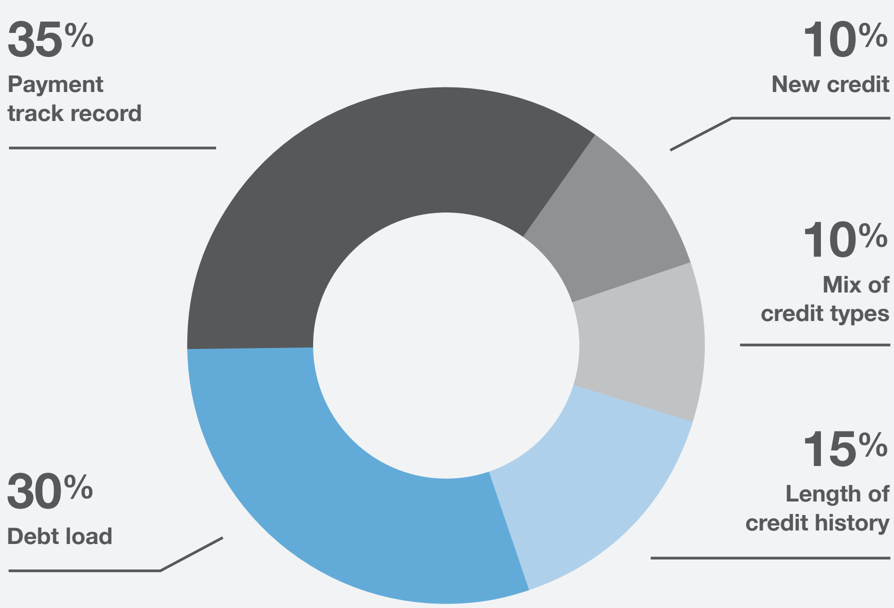
Two ratio guidelines are used:

- **The housing expense-to-income ratio (or front-end ratio)** compares your anticipated monthly mortgage payment to your total household gross monthly income (pre-taxed).
- **The debt-to-income ratio (or back-end ratio)** compares your anticipated monthly mortgage payment to your gross (pre-taxed) monthly earnings and your monthly debt requirements. Monthly debt includes credit cards, car loans, student loans and consumer loans, and includes, but is not limited to, other financial obligations such as child support and alimony.

What is a credit score and how does it affect my mortgage?

Simply put, your credit score is a number that represents your creditworthiness. It's a quick way for lenders to tell how you've managed money in the past and how much responsibility they feel you can handle given your current financial situation. Scores range from poor (300–550) to good (680–740) to excellent (740–850).

The factors considered include:



Source: Fair Isaac Corporation

Understanding the basics *(continued)*

Lenders use your credit score as one of the many indicators. Usually, the higher your credit score, the better the opportunity you'll have for a better interest rate.

A lower score? You may be a bigger risk and may be charged a higher rate in order to borrow money. Typically, any history of nonpayment or late payment lowers a credit score and raises interest rates.

What can I do to manage my credit score?

To boost and maintain a good credit score:

- Pay down revolving debt. Don't move debt around between credit cards.
- Make bill paying automatic. Set up electronic withdrawals from your checking or savings accounts to help you make timely bill payments.
- Don't open a lot of new accounts. Instead, hang on to and maintain your older accounts.
- Contact your creditors if you are having trouble. Most creditors are willing to work out a payment schedule rather than see you fall delinquent and not pay at all.

What's the difference between government and conventional loans?

Government loan

These types of mortgages have requirements established by a government agency such as the Federal Housing Administration (FHA) or U.S. Department of Veteran's Affairs (VA), and they typically have lower down payment requirements than conventional loans. Before you go this route, however, ask your home mortgage consultant to help you compare the overall costs of all products, including the monthly and long-term costs and conditions of any required mortgage insurance. In many instances, an FHA loan may be the more expensive financing option. You should consider using one only after thoroughly evaluating all the other product options that meet your credit-qualifying and financial needs.

Conventional loan

A nongovernment loan that is the most common kind of mortgage product. There are "conforming" and "nonconforming" categories, and conventional loans usually require a down payment.

Understanding the basics *(continued)*

How do I know what kind of mortgage to choose?

There are many types of mortgages available. These are some that first-time homebuyers often choose. Your mortgage professional can help you understand your options so that you can make an informed decision.

Type of loan	Features	Who may benefit?
Guaranteed Rural Development Loan Program	• No minimum down payment or reserves required • Allowable closing costs may be financed if supported by appraised value • Guarantee fee may be paid by the buyer or seller or be financed into the loan amount • May allow interested party contributions up to 6%	Homebuyers who have little or no down payment funds or cash reserves and are wanting to live in a primary residence located in a Rural Development-defined area.
VA Loan	• Low or no down payment requirement • Wide range of rate, term, and cost options • Gift funds may be allowed for all or a portion of closing costs • Financing can be assumed by veteran and nonveteran buyers when the home is sold	Active-duty or veteran military servicemembers or the spouse of someone who has served in the armed forces.
FHA loan	• Low 3.5% minimum down payment requirement • Gift funds may be allowed for all or a portion of down payment and/or closing costs • Qualified buyers can assume financing when the home is sold	Homebuyers looking for a low down payment. FHA loans have the benefit of a low down payment, but consider all costs involved, including up-front and long-term mortgage insurance and all fees. Ask your mortgage professional to help you compare the overall costs of all your home financing options.
Conventional loans	Ask your mortgage professional about available programs, such as Fannie Mae's HomeReady, and Freddie Mac's Home Possible and HomeOne.	Homebuyers looking for down payments as low as 3%.
Nonconforming loans	• Minimum 20% down payment requirement • Variety of fixed- and adjustable-rate mortgages • Loan amounts up to $2 million	Homebuyers planning to purchase a higher-priced property.

What's the difference between fixed-rate and adjustable-rate mortgages?

With a fixed-rate mortgage, the interest rate stays the same for the life of the line. With an adjustable-rate mortgage (ARM), the interest rate may go up or down on predetermined dates to reflect market conditions.

Understanding the basics *(continued)*

What's the difference between a conforming and nonconforming mortgage?

A **conventional conforming mortgage** has a loan amount and underwriting guidelines that follow standards set by the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC).

A **conventional nonconforming mortgage** has a higher "jumbo" loan amount or underwriting guidelines that differ from standards set by FNMA and FHLMC.

What if I am not able to make a 20% down payment?

There are mortgage products and programs that may help qualified first-time homebuyers achieve their goals with less available cash. Just remember, if you make less than a 20% down payment, you will likely be required to purchase mortgage insurance (MI) or pay similar fees, which adds to the cost of your loan and may increase your monthly payment and interest rate. If you know you want to become a homeowner someday, it's never too early to start building up your savings.

Can I use gifted money to help me make my down payment?

Some loan program guidelines may allow you to use monetary gifts from family or friends as part of your down payment. Keep in mind:

- You will most likely be required to provide written proof that the funds were truly a gift and not a personal loan.
- There are limits on how much gift money you can receive per year without increasing your tax obligations. Speak with a financial advisor, tax accountant, or a mortgage professional to learn more about how these options can impact your overall home financing plans and future goals.

Are there any other down payment sources I may be able to use?

Not-for-profit down payment assistance programs (DAPs) provide funds to qualified homebuyers to help with down payments and closing costs. Many DAPs don't require repayment if you meet their guidelines. Groups like Habitat for Humanity and Homeownership Alliance of Nonprofit Downpayment Providers (HAND) can also be sources of help. Your mortgage professional can help you find out which programs are available in your area, explain their details and see if you qualify.

Ready to shop for your home?

1 **Start with mortgage preapproval**

This is essential for effective house hunting. A preapproval will let you know how much you may qualify for, so you and your real estate agent can make the most of time spent looking at homes. Also, with your application, credit check and first loan decision phase already complete, you're seen as a serious homebuyer.

2 **Choose your real estate agent**

A good real estate agent should have a working knowledge of the area where you're thinking of buying. When you've got a list of potential agents, consider interviewing two or three.

Ready to shop for your home? *(continued)*

3 Pick your neighborhood

Location, location, location. There's a reason this mantra gets repeated. It's one of the most important factors in your decision to buy a home. Here are a few things to think about and to discuss with your real estate agent:

- Do the schools meet my needs?
- Is the commute time acceptable?
- Are there good public recreation areas nearby?
- Do nearby stores and services meet my needs?
- Are most of the homes in the neighborhood owner occupied?
- What population, development and economic trends are occurring in neighboring areas?

4 Look online

These days, there are many excellent websites that showcase homes for sale. Searching your price range is a good way to narrow down the field of neighborhoods you'll have to choose from and those you'd like to explore further. Write down the MLS numbers of listings that get your attention so you can give them to your real estate agent.

5 Visit local websites

Do some online research by checking out the city's website, Chamber of Commerce, and Visitor's Bureau.

Choosing your mortgage lender

We can help you understand your options and clearly explain how different loan programs work so that you can make informed decisions. Count on us to provide help and information every step of the way. Let's get started today!

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