

Find the Home Loan that Fits Your Needs

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Understand which mortgage loan is best for you so your budget is not stretched too thin.

It's easier to settle happily into your new home if you're confident you can afford it. That requires that you understand your mortgage financing options and choose the loan that best suits your income and ability to tolerate risk.

The basics of mortgage financing

The most important features of your mortgage loan are its term and interest rate. Mortgages typically come in 15-, 20-, 30- or 40-year lengths. The longer the term, the lower your monthly payment. However, the tradeoff for a lower payment is that the longer the life of your loan, the more interest you'll pay.

Mortgage interest rates generally come in two flavors: fixed and adjustable. A fixed rate allows you to lock in your interest rate for the entire mortgage term. That's attractive if you're risk-averse, on a fixed income, or when interest rates are low.

The risks and rewards of ARMs

An adjustable-rate mortgage does just what its name implies: Its interest rate adjusts at a future date listed in the loan documents. It moves up and down according to a particular financial market index, such as Treasury bills. A 3/1 ARM will have the same interest rate for three years and then adjust every year after that; likewise a 5/1 ARM remains unchanged until the five-year mark. Typically, ARMs include a cap on how much the interest rate can increase, such as 3% at each adjustment, or 5% over the life of the loan.

Why agree to such uncertainty? ARMs can be a good choice if you expect

your income to grow significantly in the coming years. The interest rate on some-but not all-ARMs can even drop if the benchmark to which they're tied also dips. ARMs also often offer a lower interest rate than fixed-rate mortgages during the first few years of the mortgage, which means big savings for you-even if there's only a half-point difference.

But if rates go up, your ARM payment will jump dramatically, so before you choose an ARM, answer these questions:

- How much can my monthly payments increase at each adjustment?
- How soon and how often can increases occur?
- Can I afford the maximum increase permitted?
- Do I expect my income to increase or decrease?
- Am I paying down my loan balance each month, or is it staying the same or even increasing?
- Do I plan to own the home for longer than the initial low-interest-rate period, or do I plan to sell before the rate adjusts?
- Will I have to pay a penalty if I refinance into a lower-rate mortgage or sell my house?
- What's my goal in buying this property? Am I considering a riskier mortgage to buy a more expensive house than I can realistically afford?

Consider a government-backed mortgage loan

If you've saved less than the ideal downpayment of 20%, or your credit score isn't high enough for you to qualify for a fixed-rate or ARM with a

conventional lender, consider a government-backed loan from the Federal Housing Administration (<http://www.hud.gov/fha/choosefha.cfm>) or Department of Veterans Affairs (<http://www.homeloans.va.gov/vap26-91-1.htm/>).

FHA offers adjustable and fixed-rate loans at reduced interest rates and with as little as 3.5% down and VA offers no-money-down loans. FHA and VA also let you use cash gifts from family members.

Before you decide on any mortgage, remember that slight variations in interest rates, loan amounts, and terms can significantly affect your monthly payment. To determine how much your monthly payment will be with various terms and loan amounts, try REALTOR.com's online mortgage calculators (<http://www.realtor.com/home-finance/financial-calculators/mortgage-payment-calculator.aspx>).

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G.M. Filisko is an attorney and award-winning writer who's opted for both fixed and adjustable-rate mortgages. A frequent contributor to many national publications including Bankrate.com, REALTOR[®] Magazine, and the American Bar Association Journal, she specializes in real estate, business, personal finance, and legal topics.