LEGEND REAL ESTATE & FINANCE

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Begin Shopping

Shop for a loan first, then for a house

WHY SELECT a loan before you begin looking at houses? Because what you can afford to spend for a home depends on the loan you get.

For example, suppose you're earning $8,000 a month. The lender will let you spend 37 percent of your income for principal, interest, property tax and insurance. That's $2,960 a month. Setting aside $560 for tax and insurance leaves $2,400 for loan payments. Get a 30-year fixed-rate loan at 7.5 percent interest and the $2,400 covers monthly payments on a $343,000 loan. If that's 80 percent of the purchase price, you can spend $430,000 for your home.

The same $2,400 also covers payments on a $380,000 adjustable-rate mortgage (ARM) at 6.5 percent interest of the first seven years of the loan. That's 80 percent of $475,000. The extra $45,000 could get you into a nicer home.

Whether you get a fixed-rate loan or ARM, here are some important questions to ask: How much money do you need? The best interest rates are on "conforming," owner-occupied home loans of up to $417,000*. They are called "conforming" loans because they conform to guidelines established by the Federal National Mortgage Association (Fannie Mae) guidelines. "Jumbo" loans over $417,000 usually run about one half of 1 percent higher than conforming loans.

How long will you need to money? It's foolish to pay a premium for a fixed rate loan if you intent to sell in four or five years. If you need a loan for a shorter period of time, investigate ARMs that have fixed rates for the first three, five or seven years and then adjust annually for the balance of the loan term. Rates on these loans are typically one half of 1 percent below fixed rate interest rates.

Is there a prepayment penalty? Some ARMs and fixed rate loans have penalties of up to six months' interest on the unpaid balance if they're paid off within five years after the loan is made. All other things being equal don't get a loan with a prepayment penalty.

Do you have rate protection? Fixed rate loan interest rates have risen by one half of a percent in less time than it takes to buy a home.

Loan discussions during pre-qualification are informational. You can't actually apply for a loan until you find a home to buy. When that time comes, be aware that it's possible to protect your loan's interest rate from potential increases by "locking in" the rate. Some lenders protect the rate when the loan application is submitted. Others don't lock the rate until the loan is approved, which could take several more weeks. Some lenders won't lock in the rate until the sale closes.

*The U.S. Congress extended through 2010 conforming loan limits of $417,000 for most areas in the U.S. and $729,750 for high-cost areas, including many in California.

Avoid “rate shock”… the best way is to use a lender who’ll protect the rate when your request is submitted. What are normal charges associated with loan? Charges for a home appraisal and credit report, etc. don’t change much from lender to lender. Neither do title insurance and escrow fees. Loan origination fees (prepaid interest called “points”) are the biggest expense item. Each point equals 1 percent of the loan amount. Points vary widely. If a lender charges 2 points for a loan with the exact same interest rate and another lender will give you a loan for 1.5 points, use the less expensive lender. What about “no points” loans? While they always have higher interest rates than similar loans with points, they may be right for you. It depends how long you plan to keep the loan. Say the monthly payment on a $200,000 “no points” loan is $50 per month higher payment and you get 40. That means you break-even at 40 months. If you’ll keep the loan for less than 40 months, get the “no points” loan. If you’ll have it more than 40 months, you’re better off paying points. Again, watch out for prepayment penalties.

Which is better- an ARM or a fixed rate loan? Since ARMs are initially cheaper than fixed rate loans, they’re great if you plan to keep the loan four or five years. ARMs have caps to limit increases at periodic adjustment intervals and over the life of the loan. But, they’re still riskier than fixed-rate loans over the long haul. No one knows when inflation will come roaring back. If an ARM’s volatility bothers you, get a fixed rate loan. You’ll sleep better.

This was taken from a newspaper article. The loan amounts have been increased to be more realistic - Jerry

Raymond Brown
S.F. Sunday Examiner & Chronicle