

The type of mortgage you choose should be based on your financial situation today, your best estimate of what it will be in the future, how long you plan to own the home or “stay in” the mortgage and your comfort level with assuming the risk of potential increases in required payments.

The Simple Facts™ was created by the Mortgage Bankers Association — not any single lender — to help you easily identify the pros and cons of each type of mortgage and choose the one best for you.

Inside you will find brief descriptions of different types of mortgages, reasons some people choose each particular mortgage and why others avoid them, and a set of questions everyone should ask their lender before making their final loan choice. You should use it along with other information on interest rates, lender fees and closing costs.

There are two basic categories of mortgages: fixed-rate mortgages and adjustable rate mortgages (ARM). Within each category, there are variations.

However, in nearly all mortgages, two factors are at play: how predictable the payments are and how low, or affordable, they are — at least initially.

Borrowers choose fixed-rate mortgages because the principal and interest payments are steady and predictable. But in so doing, they pay a higher interest rate than on an ARM. They may also give up the opportunity to get a lower rate without refinancing if interest rates fall.

Borrowers choose adjustable rate mortgages because the initial principal and interest payments are usually lower. A lower initial payment can make the home more affordable at first, but the borrower must also be willing to accept the risk of — and be confident in their ability to afford — a potentially higher principal and interest payment when the rate adjusts upward. The adjustment date varies, but is specified in the mortgage documents. Depending on the loan, it can occur even within the first year and sometimes results in significantly higher principal and interest payments. With some mortgages, there’s even the possibility of an increasing loan balance.

Why do different types of mortgages offered at the same time have different rates? Mortgage interest rates vary based on who (borrower or lender) assumes more of the risk of interest rate hikes and for how long. Adjustable rate mortgages usually offer lower initial rates because the borrower assumes a greater share of the risk of interest rate increases. A fixed-rate mortgage usually has a higher interest rate because the lender loses the ability to get a higher return if rates increase.

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Fixed-rate mortgage Offers predictable, fixed payments over the life of the mortgage, regardless of how interest rates change in the marketplace.

Reasons to choose a fixed-rate mortgage

The principal and interest portion of your mortgage payment doesn't change — easier budgeting and financial planning.

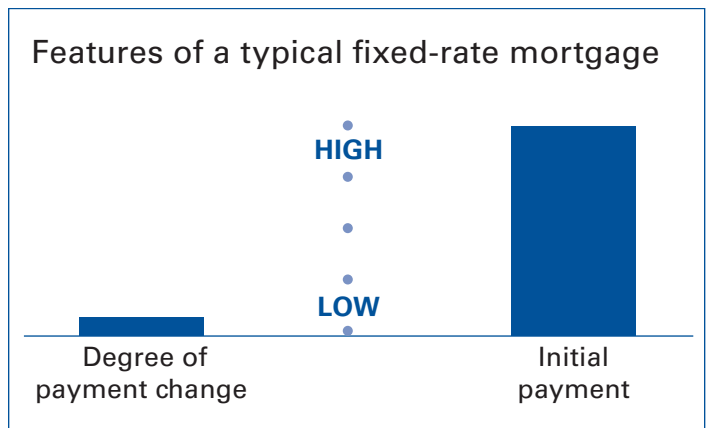
Reasons not to choose a fixed-rate mortgage

Principal and interest payments are usually higher than most adjustable rate mortgages, at least in the initial years. To take advantage of an interest rate decrease, you would have to refinance and incur the costs of that refinance.

People who choose a fixed-rate mortgage

Those more comfortable with the safety and security of steady and predictable principal and interest payments that do not increase if interest rates rise.

Those planning to keep their home and mortgage for several years.



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Adjustable rate mortgage (ARM) Usually offers a lower initial interest rate and lower interest payments than most fixed-rate mortgages. However, payments will adjust up and down based on a specific interest rate index (such as the LIBOR rate) plus an additional amount, called a margin. These adjustments occur at times specified in the loan documents and can result in significant payment increases. Rate caps at each adjustment and over the life of the mortgage may offer some protection against these increases.

Reasons to choose an ARM

Lower initial interest payments.

If rates drop, payments may become lower without refinancing.

Reasons not to choose an ARM

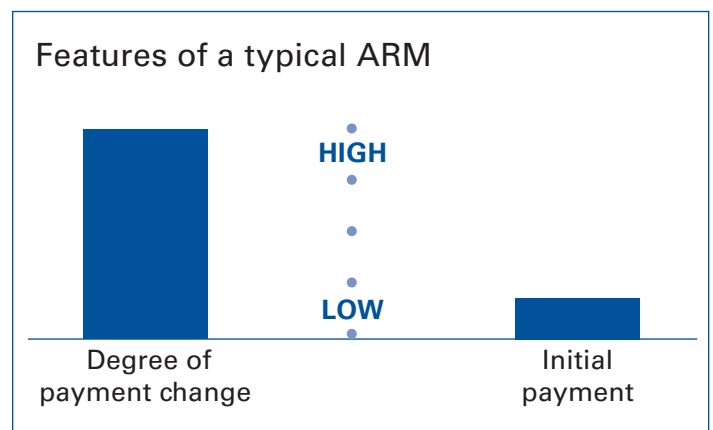
If rates increase, interest payments increase.

People who choose an ARM

Those who are confident they can continue to make payments even if principal and interest amounts increase significantly.

Those who believe rates will remain low or even decrease and want to easily take advantage of lower principal and interest payments.

Borrowers who plan to own the home for a limited time and believe home values are steady or increasing.



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Payment shock “Payment shock” is a term used by some to describe significant increases in the payment required, which can lead to severe borrower hardship. Remember, the greater a mortgage’s potential for increases in payment amounts, the higher your risk of “payment shock.” Asking many of the questions on the next page can help keep you from experiencing “payment shock.”

Loans with prepayment penalties or fees

Prepayment penalties or fees are an additional lump sum required if the mortgage is paid off either through refinance or home sale before a specified date. Find out if your mortgage has one. If it does, know the amount of the penalty and the date the penalty ends. Ask if you are receiving a benefit, such as a lower rate, in exchange for the prepayment fee. If you plan to stay in the home throughout the prepayment penalty period, the savings may be significant. However, if you are planning to sell or refinance during the prepayment penalty period, make sure the benefit offered outweighs the fee.

Loans allowing interest-only payments

An interest-only option is a feature of some mortgages or home equity lines of credit. However, it is typically available only for a limited time, after which payments may go up, sometimes significantly, because the borrower must begin making principle plus interest payments. Also, the principle usually must be repaid over a short period (e.g. 20 years). While offering lower payments initially, paying only the interest does not reduce the principal due.

Loans with balloon payments A mortgage with a balloon payment requires that the borrower pay all of the remaining principal on the loan in a relatively short time, often within five years of taking the mortgage. Agreeing to a balloon can get you a lower interest rate and monthly payment. However, as you can imagine, very few people can pay off their mortgage all at once. For this reason, borrowers usually refinance before the balloon payment is due. You should be told if your mortgage has such a payment, but be sure to ask. If you do choose a loan with a balloon payment, you must be completely sure of your ability to refinance or otherwise pay off the balance. Remember, falling real estate prices and increasing rates can affect that ability.

Responsibility for paying taxes, insurance and other costs

A homeowner’s responsibilities include more than the payment of interest and principal. They also include the payment of property taxes and homeowner’s insurance, and sometimes private mortgage insurance (PMI), condominium and association fees, payments on a second mortgage and other expenses. Many lenders require that you include some of these costs in your mortgage payment. The money goes into an escrow account and is paid out when due. If these amounts are not escrowed, they are still your responsibility under the terms of your mortgage. You should budget accordingly.

Note on the effect of falling housing prices

While over the long-term, homes historically increase in value, there are ups and downs in the real estate market. These variations can have an impact on borrowers, especially those planning to move or refinance prior to an anticipated rise in rates and, therefore, mortgage payments. A fall in home prices or a rise in interest rates may make it much more difficult for those borrowers to sell or refinance without losing money. Some geographic areas with high unemployment may experience housing price drops for a prolonged period of time.

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Questions to Ask Your Lender

About any Type of Mortgage

Can my interest rate and monthly principal and interest payment go up over time?

Can my loan balance go up, even if I make minimum payments on time?

Will my mortgage payment include insurance, taxes and other charges?

Will I have to pay a prepayment fee if I pay off the loan in full ahead of schedule?

If so, how much is the fee?
For how long is it in effect?

If I agree to a prepayment fee, what do I get in return?

Can I make extra payments to reduce principal?

Does this loan have a balloon payment?

If so, how much? When is it due?

Will the lender be obligated to refinance my balloon payment mortgage?

Will I have to pay an additional fee if a payment is late?

About ARMs

How much higher can my payments go when the mortgage first adjusts?

(Assuming today's interest rate, but remember, the rate will likely be different when your fixed period ends.)

After the first adjustment, exactly when, and how often, does my rate and payment amount adjust?

What's the most my payment can increase?

About a Mortgage Allowing Interest-only Payments

How long can I make interest-only payments?

Can I also pay down principal?

What will my payments be after the interest-only period is over?

Fixed vs. Adjustable in a Nutshell

Mortgages with payment adjustments usually result in lower payments at first but expose you to the risk of possibly significant payment increases if interest rates go up. Mortgages with predictable, fixed payments could cost you more over the life of the mortgage, and require refinancing (and its costs) to take advantage of falling interest rates.

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Notes

A series of horizontal dashed lines for taking notes.



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