Mortgages

A mortgage loan is a loan that a bank or lender gives you to help finance the purchase of a house. The house you buy acts as collateral in exchange for the money you are borrowing to finance the mortgage for a house. A mortgage payment is generally composed of four parts: principal, interest, taxes and insurance. It is normally paid on a monthly basis.

- Principal – Principal is the total amount of money you borrowed to buy the home (if you have a $150,000 mortgage loan, the beginning principal balance is $150,000).
- Interest – Interest is the price you pay to borrow money from your lender.
- Taxes – Taxes are the property taxes you pay as a homeowner. They are typically calculated based upon the value of your house.
- Insurance – Insurance includes homeowners insurance and could include mortgage insurance. You are required to get homeowners insurance by your lender to cover your house. If your down payment is less than 20%, you will have to pay mortgage insurance which protects the lender if you default on your mortgage loan.

Many lenders set up an escrow account for the collection and disbursement of property taxes and insurance. While the account is created and maintained by the lender, it is funded by the borrower.

Choosing the right type of mortgage is one of the most important financial decisions you will need to make. Listed below are the most common types of mortgages.

Conventional Mortgage (Fixed Rate): A mortgage where the interest rate remains the same throughout the life of the mortgage. (Your monthly payment may increase or decrease if your loan includes an *escrow account because the escrow portion of your payment is based on your current taxes and insurance costs and/or any advances or deficiencies.)

Adjustable Rate Mortgage (ARM): A mortgage that generally offers a lower initial rate or interest rate than fixed rate mortgage loans. After the initial period, rates fluctuate over the life of the loan.

FHA (Federal Housing Agency) Mortgage: This type of loan can be either a fixed rate or an adjustable rate mortgage. Borrowers are required to pay Mortgage Insurance Premium (MIP, see below) for this loan which provides the lender government protection in the event that the borrower defaults on the loan. The down payments associated with these types of loans are typically much lower than a Conventional Mortgage; however, the maximum amount of the loan may be limited.

Interest Only: This type of loan allows the borrower to pay only the interest due on the loan, in monthly payments for a fixed term. During this term, the principal balance remains unchanged. After the fixed term, the balance of the loan is due in full, or principal payments may be required in addition to the interest payment creating a much higher monthly payment.

Balloon Mortgage: A mortgage that usually includes a fixed rate with relatively low payments for a fixed period of time. At the end of the fixed period, the entire balance of the loan is immediately due.

VA Loans: These types of mortgages are exclusive to eligible veterans, active duty personnel and surviving spouses. These loans offer competitive interest rates, with low or no down payment because they are insured against loss by the Veterans Administration.

Second Mortgage: A second mortgage is a second lien on a property (that is already secured by mortgage, and/or first lien). Many times second mortgages are a Home Equity Loan or a Home Equity Line of Credit (see below). Your home's equity is the difference between what you currently owe on your home (any existing mortgages) and what your home is worth (usually determined by an appraisal).

A Home Equity Loan provides the total amount borrowed to the borrower at once, in a lump sum payment. Home Equity Loans are typically offered with a fixed interest rate, meaning the interest rate will not increase or decrease over time. These loans are commonly repayable over five to 10 years, and include a fixed monthly payment.

A Home Equity Line of Credit, also known as a HELOC, provides a set loan amount which can be borrowed all at once, or may be withdrawn in increments as needed (similar to a line of credit). Typically, the interest rate for a HELOC is variable, meaning it can increase or decrease over time. The monthly payment will depend on the interest rate and the outstanding principal balance.

Reverse Mortgage: A loan that is only offered to a borrower that is 62 years of age or older. This loan allows borrowers to convert the equity in their home to cash. You do not have to pay back the loan and interest as long as you are living in the house (but it must be paid back when the property is sold, the borrower moves out, or the borrower dies). More information on these types of mortgages can be found on a separate page in this toolkit.

PMI (Private Mortgage Insurance) vs. MIP (Mortgage Insurance Premium): Conventional mortgages have PMI and FHA loans have MIP.

PMI: Mortgage insurance provided by private mortgage insurance companies for borrowers when the down payment made is less than 20% of the homes purchase price. This insurance is paid by the borrower, but benefits the lender, as it protects the lender against loss if the borrower defaults.

MIP: The upfront and/or periodic charges that the borrower pays for mortgage insurance (paid to the lender) in case of default. There are different mortgage insurance plans differing combinations of monthly, annual, and upfront premiums.

Additional information about mortgage loans can be found att he following sites:
The United States Government (800-333-4636 or at www.usa.gov)
The Consumer Financial Protection Bureau (855-411-2372 or at www.consumerfinance.gov)
The Mortgage Encyclopedia, by Jack Guttentag (www.mtgprofessor.com)
Bankrate.com (www.bankrate.com)

* Escrow Account - This is an amount of money maintained at a lending institution in order to pay the annual taxes and insurance on mortgaged property. Approximately one-twelfth of the estimated annual cost of taxes and insurance is paid into the account each month from the borrower’s monthly mortgage payment. Then the lending institution pays the taxes and insurance from this account when they are due. An escrow account is required by many lending institutions in order to ensure that the taxes and insurance premiums are paid on time.