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What is APR and What Does It Mean for a Mortgage Loan?

When starting the search for a new mortgage loan, you will run into all sorts of important mortgage terms and phrases. You will learn quickly that two of the most vital words to know and understand are “interest rate” and “closing costs.” Another one you may encounter is “APR.” What is this acronym and what effect will it have on your mortgage?

APR stands for “annual percentage rate.” It is not actually a number that affects the cost of your loan, but it is a number aimed at helping borrowers figure out the true cost of a mortgage loan. You already know how important it is to obtain a great interest rate; the difference of one percentage point could save or cost you tens of thousands of dollars in interest payments. Yet you should also know that the interest rate is not the only expense in a home mortgage. Every lender includes closing costs at the signing of the loan contract. These are all the costs associated with the processing of the loan, things like appraisal fees, attorney fees, and your broker’s personal fees.

The APR was designed to take into account these fees and make it easier to compare different loan programs. The intent was to have a number that would reflect the total cost of the loan, taking into account both the interest rate and closing costs. In fact, the Federal Truth in Lending law made it a requirement for all mortgage lenders to list the APR when posting their rates in newspapers or on websites.

Unfortunately, calculating the APR can be a complex and confusing process. To make matters worse, not all lenders calculate the rate in the same way. So even though the APR was intended to prevent lenders from deceiving borrowers with ultra-low interest rates while beefing up their fees, it is not always such an effective way of comparing lenders’ offers.

Neither does APR truly include all of the costs of your loan. The typical closing costs that are included in the calculations are things like discount and origination points, pre-paid interest, underwriting charges, fees for processing the loan and preparing documents, and private mortgage insurance costs. Yet lenders generally do not incorporate escrow or attorney fees. Neither do they include title or notary charges, transfer or appraisal fees.

The good news is that many mortgage websites offer APR calculators to help you in figuring out the APR for several loan offers. If it all seems too complicated, you can still get an accurate comparison of loan costs by going the old fashioned route. Get quotes from different lenders on the exact same program with the exact same interest rate. Compare the closing costs estimated by each lender. The one with the lowest amount of fees will be the one that is truly offering the best deal.

When you begin looking for a mortgage loan, understanding the meaning and calculation of APR can be a helpful in finding the right loan for your budget. Make sure however that your lenders include the same fees in their computations to make sure the APR is a correct measure of the cost of the loans. If you ever find it too confusing though, be sure to talk with the mortgage lender to find out the dollar amount you will pay in closing costs and interest.